S. HRG. 101-1096

THE CONDITION OF THE THRIFT INDUSTRY

HEARINGS

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

THE STATE OF THE THRIFT INDUSTRY AND THE SCOPE OF THE PROBLEMS IN TRYING TO STOP THE LOSSES, CLOSE DOWN THE INSOLVENT THRIFTS, SELL THE ASSETS FROM THOSE THRIFTS, PROSECUTE AND JAIL THOSE WHO ARE CRIMINALLY RESPONSIBLE FOR MANY OF THESE LOSSES, AND PUT IN PLACE A SUPERVISORY STRUCTURE AND EXAMINATION PROCESS THAT ENSURES WE NEVER FACE THIS TYPE OF CRISIS AGAIN

SEPTEMBER 25 AND 27, 1990

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THE CONDITION OF THE THRIFT INDUSTRY

TUESDAY, SEPTEMBER 25, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:16 a.m., in room SD-538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

Present: Senators Riegle, Dixon, Cranston, D'Amato, Kerrey, Heinz, Kerry, and Sanford.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

Let me thank our witnesses for their patience. We had other matters intrude this morning that necessitated a later start.

As you know, at this time of the year in the congressional session with the budget summit and House-Senate conferences going on and so forth, those things can happen.

I want to just indicate at the beginning that Senator Garn regrets that he cannot be here today.

He is testifying on the House side before the Interior Committee on water measures in Utah on Cason Point, but he wants to thank the three very distinguished witnesses for testifying on the conditions of thrift industry, and he looks forward to reading the transcript of today's hearing.

Let me just make a few opening comments myself and then yield to my colleague, Senator Dixon.

Certainly the problems of the thrift industry are very widely reported and widely known. The administration introduced its savings and loan reform bill 18 days after President Bush took office, and that FIRREA legislation, as it is called, is now over 1 year old.

Some are saying that it is time to review it and determine if improvements can be made. They say reform is necessary because of the escalating cost of the savings and loan bailout, the declining health of parts of the thrift industry, and the multiple layers of bureaucracy dealing with various parts of the problem.

So I think it is necessary for Congress and this committee to take up this task of assessing where we are and whether changes of some sort or form are needed.

I also know that Senator Wirth is very interested in that issue.

One fundamental issue is whether the basic Federal charter of a savings and loan provides the opportunity to the management for being able to produce consistent profits while still operating on a safe and sound basis.

The nature of that business charter question I think is a central one. It was one that, in dealing with the emergency situation that we were facing last year, probably was not able to get the kind of sophisticated analysis and intention that it may and almost certainly did require.

We did the best we could under the circumstances, but I think that is an issue that is worth further discussion and debate at this time.

I think another major question is whether the administrative apparatus of the RTC as is is what it should be, or whether it can be changed and should be changed and in some way improved.

Today we are going to hear from representatives of the healthy segment of the thrift industry. Our findings have been that plain vanilla thrifts have been the most successful.

Staying with the market you know, controlling overhead costs, and getting back to basics is not the material for headlines, but it appears to have been the prescription for safe and sound operations and profitable operations up and down business cycles over a period of years.

Today we will hear from the management and former management of a small thrift, a medium-sized thrift, and one of the largest thrifts in the country.

Despite the differences in size of their institutions, our witnesses prepared testimony that stresses the importance of sticking to the basics and the fact that a thrift industry can in fact be profitable.

Our witnesses today are William Glencorse, the chief executive officer of First Federal Savings and Loan of Lenawee County in Adrian, MI; Edmond Shanahan, chief executive officer of Bell Federal Savings of Chicago, IL; and Anthony Frank, a former chief executive officer of First Nationwide Savings and Loan of San Francisco, CA, who is currently of course serving as our Postmaster General of the United States.

I welcome them and very much look forward to their testimony.

I might say, as well, that Senator Bob Kerrey of Nebraska has long had an interest in the subject matter of today's hearings, and he has asked if he might participate in this hearing even though he is not a member of the committee, and I hope that he will be able at some point to join us and participate in the questioning.

Senator Dixon?

OPENING STATEMENT OF SENATOR DIXON

Senator DIXON. Well thank you very much, Mr. Chairman. I am pleased to be here this morning as the Senate Banking Committee continues its oversight of the thrift industry.

I am especially pleased that the chairman had the foresight to invite Edmond Shanahan, chief executive officer of Bell Federal Savings in Chicago, to testify today.

Bell Federal has 8 percent tangible capital, is profitable, and is very safe and sound, and I congratulate my friend, Ed Shanahan, for his success.

As we focus on the problems in the thrift industry, we ought not to forget that there are healthy institutions like Bell Federal around. We have a lot of issues to cover today:

Whether the thrift industry can survive;

Are any changes to FIRREA needed?

What can be done to save taxpayers money in resolving failed thrifts?

How can both the OTS and the FDIC be made more efficient?

I am very interested in some of the suggestions Mr. Frank has, Mr. Chairman, which I think kind of are shared views of our friend, the junior Senator from Nebraska, Senator Kerrey, who I think wants to be here for that reason, Mr. Frank.

I would like to offer one comment in addition. William Glencorse, the chief executive officer of First Federal Savings and Loan in Adrian, MI, your home State, Mr. Chairman, endorses in his testimony the concept of risk-based insurance premiums. As you know, 2 weeks ago I introduced a bill to implement that concept.

Incidentally, I noticed, Mr. Chairman, and hope my distinguished friend, the Senator from Michigan noticed, in today's Washington Post on the editorial page a very, very interesting discussion of that concept which I would recommend to my colleagues.

Those institutions with lots of capital and safe portfolios should not be subsidizing those banks and thrifts who have neither.

That unfortunately is the situation today with uniform premiums, and my bill would correct those perverse incentives.

S. 3040 would also mandate early closure, and also would mandate annual safety and soundness examinations which I am delighted to see the Chair incorporates in his very important major legislation he introduced this week.

I appreciate of course Mr. Glencorse's views on risk-based deposit insurance. I look forward to his testimony and that of my friend, Ed Shanahan, and Postmaster General Frank.

Now, Mr. Chairman, may I apologize. At some point pretty soon I have to leave.

Ed Shanahan will understand that our distinguished Mayor Richard M. Daly is in town. I had dinner with him last night and I am obligated to be with him about quarter to 11 to visit with the major leader and others about legislation to advance the interests of the third airport of our great city.

I hope you will excuse me for leaving for that reason.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Dixon.

I appreciate your comments and your leadership on these important issues, as well.

Mr. Glencorse, we will start with you.

STATEMENT OF WILLIAM H. GLENCORSE, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, FIRST FEDERAL SAVINGS AND LOAN OF LENAWEE COUNTY, ADRIAN, MI

Mr. GLENCORSE. Thank you, Mr. Chairman.

The CHAIRMAN. Let me say to all the witnesses, we will make your full presentations a part of the record, and I would like you to feel free to summarize and go right to the meat of what you want us to hear.

Mr. GLENCORSE. Thank you very much for giving me the opportunity to appear before the committee this morning to talk about the impact of FIRREA and the future of the thrift industry.

By way of Adrian, MI. I am chairman and chief executive of a $220 million asset sized institution in Adrian, which is about 60 miles southwest of Detroit.

On June 30, 1990, First Federal Savings and Loan of Lenawee County had total assets of $221 million; loans receivable of $158 million; deposits of $181 million; and stockholders' equity of $35 million, or 15.8 percent of total assets.

On June 30, 1990, First Federal had no troubled assets or real estate owned. For the first 6 months ended in June 30, 1990, First Federal had net income of $1.25 million, or 76 cents per share, the equivalent of $2.5 million or $1.52 per share on an annualized basis.

First Federal is currently earning approximately 115 basis points return on average assets. Our institution focuses almost exclusively on the origination of single family home mortgage loans in our local market area.

We do not make commercial business loans or any significant amount of consumer loans. We believe we understand our market very well and can be competitive in the single family home mortgage loan area.

We believe we can and do operate with great efficiency by concentrating on the area of business we know best.

You have asked my thoughts on the implementation of FIRREA, what can be done to save the taxpayers money in the resolution of the failed thrifts, and what is the future of the thrift industry.

In the case of FIRREA, it was overdue but somewhat overdone. The good points brought about by FIRREA are:

The higher capital standards requiring thrift owners to risk their own money rather than the taxpayers money through Federal deposit insurance in order to engage in higher risk activities;

Increased enforcement activities; and

The restrictions on nontraditional lending and other activities unless supported by higher capital levels.

The higher capital standards, we have already seen the effects of these new requirements in many, many thrift institutions we compete with because they are returning to their roots, focusing on the core business of single family lending which we view as the reason for the existence of a thrift institution.

I do not believe there is any significant opposition either among members of the general public or my thrift institution colleagues to these higher capital requirements.

Increased enforcement activities: I believe it is very appropriate to pursue these people that have devastated the industry and agree that they should not be allowed to walk away with the millions of dollars they garnered in very questionable dealings.

I am concerned, however, that the focus of Congress and the regulators should not be narrowed to the enforcement area as this is largely a matter of pursuing the horses which have already escaped the burning barn.

I believe it is essential to maintain the value of the thrift charter through both legislative and regulatory initiatives in order to

ensure the continued health and viability of the majority of the thrift industry that is now operating and has always operated safely and responsibly.

The restrictions on lending and other thrift activities: Some of these major elements of FIRREA which have dramatically impacted the way many thrifts do business have not affected First Federal of Lenawee.

The changes in the loan-to-one-borrower regulation, qualified thrift lender requirements, restrictions on commercial lending based on total capital of the thrift, and the increased capital required for a thrift to engage in nontraditional activities have similarly had absolutely no effect on our institution.

Our largest single loan, or loan concentration is approximately $550,000. The 70 percent qualified thrift lender test is not an issue for an institution like ours, as approximately 90 percent of our assets would qualify.

We do not do any commercial lending, so the restrictions in this area do not impact us. And because we limit our activities primarily to single family lending, the increased capital requirements to engage in nontraditional activities have no effect on us.

I realize that many of the thrifts that testify before this committee may be facing dissimilar circumstances.

I can only tell you, however, that the major components of FIRREA that may be troublesome to other thrift institutions have no effect on our operations.

I would like to point out some of the problems I believe FIRREA has engendered:

Higher deposit insurance premiums for thrifts versus banks;

Misguided OTS examination procedures; and

The redundant and confusing SAIF and BIF insurance funds.

The higher deposit insurance premiums for thrifts versus banks: For those of us who operate in a traditional, conservative, and safe manner with ample capital, the penalty for subsidizing the failures of others is too great.

It is simply not fair and, ultimately if the premiums become too onerous, it is not healthy for the remaining portion of the thrift industry or the taxpayers.

Imposing on the surviving thrifts a disproportionate share of the burden of paying for deposit insurance and funding the costs of past mistakes will only further weaken the value of the thrift franchise.

I believe this is a serious mistake which is likely to result in increasing the ultimate cost to the public if not corrected.

The misguided examination procedures: We have had just the one examination since the OTS came into being, and I would just like to walk you through it, that we are the only thrift institution or bank that I know of that can report absolutely no nonperforming assets or real estate owned.

Our largest loan has a 67 percent loan-to-value ratio. We have absolutely no loans outside of our local market area.

Not withstanding all of the difficulties and problems facing this industry over the last 20 years, we have never lost money.

In spite of this record, during our last examination we had a team of five examiners for 40 business days disrupting the oper-

ation. This process cost us over $29,000 in 1989 as compared to $16,000 in 1987, the year of our last examination, and resulted in absolutely no benefit to our institution, the supervisory process, or the public.

I view the examination process as critical to the integrity and long-term survival of the thrift industry. I do not believe the system is functioning properly, however, when an institution such as ours ties up five examiners for 40 business days and results in a report showing no significant problems or deficiencies.

Incidentally, the FDIC came in concurrently with the OTS and their examination took a day-and-a-half and showed no problems or deficiencies, either.

The redundancy of SAIF and BIF: I do not see any advantage to maintaining the dichotomy between commercial banks and thrift institutions' insurance systems.

The FDIC controls both funds and, as I am certain this committee is all too painfully aware, the real estate problems facing our financial institutions, both thrifts and banks, do not differentiate in their impact on individual institutions.

I cannot discern any rational basis for maintaining the dual funds and believe that the public should not be further confused by SAIF insurance versus BIF insurance when it comes to their savings.

If the Government indeed stands behind its guarantee, then all financial institutions should operate on a level playing field according to risk.

I believe risk-based premiums make a great deal of sense, probably because we operate so risk-free and believe risk-based premiums would be appropriate for both thrifts and banks. I note that the OTS has recently instituted a program of increased assessments for the weakest thrifts requiring the greatest supervision. This is a positive step in creating a fair environment with which we can compete.

You have asked about the additional regulations. Might I sum that up by saying that, from a very unsophisticated standpoint, I measured with a ruler the rules and regs of the banks and it comes out to about a half-inch, and for the thrift industry close to 4 inches. This is very, very unsophisticated and admittedly less than precise, but we are so frightened because of the various and sundry things that are happening, we have three attorneys on staff. We have one heading up our lending division, another attorney heading up the liability division, and in-house counsel plus outside experienced counsel to help us out in the nightmare of trying to keep up with the regulations.

This is not in my text, but every Monday morning, without a doubt, I receive from the Office of Thrift Supervision, or from the Indianapolis division of OTS, at least a half-inch of new regulations governing something pertaining to the business. Two-thirds of them do not affect me. I send them up to legal counsel and have them read them. However, if I just give them an eyeshot, I am frightened that I am going to miss something or not know about it, and it is just becoming overwhelming to try to manage a small shop such as ours.

The CHAIRMAN. I am going to just interrupt for a minute, because I know Senator Dixon wants to hear some of Mr. Shanahan's testimony because he has got to go meet with the mayor of Chicago, and I do not want to hurry you, but if I can—because I see the red light is on—if you could maybe just finish your comments, Mr. Glencorse, in maybe another minute so we could go to Mr. Shanahan.

Mr. GLENCORSE. All right.

You have read the comments, but the one thing about taxpayer money and the resolution of failed thrifts, I believe honestly that the RTC must be allowed to operate in a manner that they can accomplish the job they were set up to do.

They are hamstrung today. They cannot move. The publicity that they have to go through to sell some of the assets of the thrifts is just unwieldy. They cannot do their job because of the constraints of the Congress and the regulators. They must—they must—have the ability to move forward and get rid of the assets.

You do not have to have your doctorate degree to figure out that with the billions of dollars of assets that are being held by the Government, the largest holder of real estate in this country, the cost of administrating to these various assets has become overwhelming.

They cannot move in any direction at all. It is always referred back to a committee. You must give them the opportunity. My thought is to sell these assets at what the market will bring. Forget the appraisal. I have heard all this nonsense about "soft markets," that you will depress the market, that you will do this, and you will do that. The only winners will be the person that puts up his or her capital, or their capital to buy these assets and have them become profitable. They will be the only winners.

Historically in this country of ours we have gone through the recessions and the depressions. Through all of the years, real estate has always come back. The only winner will be private enterprise, and it will help this country of ours by getting rid of these nonperforming assets and get money into the coffers so we can get on with the business of assuring the American public of a sound financial structure.

Thank you, Mr. Chairman.

[The complete prepared statement of William H. Glencorse follows:]

TEXT OF COMMENTS OF WILLIAM H. GLENCORSE,
CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER OF
FIRST FEDERAL SAVINGS AND LOAN ASSOCIATION OF LENAWEE COUNTY,
ADRIAN, MICHIGAN,
ON THE EFFECTS OF FIRREA AND THE FUTURE
OF THE THRIFT INDUSTRY
UNITED STATES SENATE COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
September 25, 1990

Thank you very much for giving me the opportunity to appear before this Committee this morning to talk about the impact of FIRREA and the future of the thrift industry. I am the Chairman of the Board and Chief Executive Officer of a $220 million asset size thrift institution in Adrian, Michigan, which is about one hour southwest of Detroit. At June 30, 1990, First Federal Savings and Loan Association of Lenawee County had total assets of $221 million, loans receivable of $158 million, deposits of $181 million and stockholders' equity of $35 million, or 15.8% of total assets. At June 30, 1990 First Federal had no troubled assets or real estate owned. For the six months ended June 30, 1990, First Federal had net income of $1.25 million, or $.76 per share, the equivalent of $2.5 million, or $1.52 per share on an annualized basis. First Federal is currently earning approximately [115] basis points return on average assets. Our institution focuses almost exclusively on the origination of single-family home mortgage loans in our local market area. We do not make commercial

business loans or any significant amount of consumer loans. We believe we understand our market very well, and can be competitive in the single-family home mortgage loan area. We believe we can and do operate with great efficiency by concentrating on the area of business we know best.

You have asked for my views on three issues:

1) **WHAT IS MY OPINION OF THE IMPLEMENTATION OF THE FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989? WHAT ADDITIONAL REGULATIONS, IF ANY, SHOULD BE ADOPTED?**

2) **WHAT CAN BE DONE TO SAVE THE TAXPAYERS MONEY IN THE RESOLUTION OF FAILED THRIFTS?**

3) **WHAT IS THE FUTURE OF THE THRIFT INDUSTRY? CAN INSTITUTIONS THAT HAVE STAYED WITH THE TRADITIONAL THRIFT BUSINESS OF MAKING HOME LOANS SURVIVE?**

I would like to respond to each of these issues in order. Please note that these comments are my own and do not necessarily represent the views of my board of directors or other thrift institutions.

1) **MY OPINION OF THE IMPLEMENTATION OF FIRREA** is that it was overdue but somewhat overdone. The good points brought about by FIRREA are:

a) higher capital standards requiring thrift owners to risk their own money rather than the taxpayers' money through federal deposit insurance in order to engage in higher risk activities;

b) increased enforcement activities; and

c) restrictions on non-traditional lending and other activities unless supported by higher capital levels.

a) *Higher capital standards.* We have already seen the effects of these new requirements in that many, many thrift institutions we compete with are returning to their roots, focusing on the core business of single-family lending, which we view as the reason for the existence of a thrift institution. I do not believe there is any significant opposition, either among members of the general public or my thrift institution colleagues, to these higher capital requirements.

b) *Increased enforcement activities.* I believe it is appropriate to pursue those people that have devastated the industry and agree that they should not be allowed to walk away with the millions of dollars they garnered in very questionable dealings. I am concerned, however, that the focus of Congress and the regulators should not be narrowed to the enforcement area, as this is largely a matter of pursuing the horses which have already escaped the burning barn. I believe it is essential to maintain the value of the thrift charter through both legislative and regulatory initiatives in order to ensure the continued health and viability of the majority of the thrift industry that is now operating and has always operated safely and responsibly.

c) *Restrictions on lending and other thrift activities.* Some of the major elements of FIRREA which have dramatically impacted the way many thrifts do business today have not affected First Federal. The changes in the loan to one borrower regulation, the

qualified thrift lender requirements, the restrictions on commercial lending based on the total capital of a thrift institution, and the increased capital required for a thrift to engage in non-traditional activities have cumulatively had absolutely no effect on our institution. Our largest single loan or loan concentration is approximately $550,000; the 70% qualified thrift lender test is not an issue for an institution like ours, as approximately 90% of our assets would qualify; we do not do any commercial lending, so the restrictions in this area do not impact us; and because we limit our activities primarily to single-family lending, the increased capital requirements to engage in non-traditional activities also have no effect on us. I realize that many other thrifts that testify before this Committee may be facing dissimilar circumstances. I can only tell you, however, that the major components of FIRREA that may be troublesome to other thrift institutions have had no impact on our operations.

I would like to point out some of the problems I believe FIRREA has engendered:

a) higher deposit insurance premiums for thrifts versus banks;

b) misguided OTS examination procedures; and

c) the redundant and confusing SAIF and BIF insurance funds.

a) *Higher deposit insurance premiums for thrifts versus banks.* For those of us that operate in a traditional, conservative and safe manner, with ample capital, the penalty of subsidizing the failures of others is too great. It is simply not fair and,

ultimately, if the premiums become too onerous, is not healthy for the remaining portion of the thrift industry or the taxpayers. Imposing on the surviving thrifts a disproportionate share of the burden of paying for deposit insurance and funding the costs of past mistakes will only further weaken the value of the thrift franchise. I believe this is a serious mistake which is likely to result in increasing the ultimate costs to the public if not corrected.

b) *Misguided examination procedures*. As I mentioned earlier, we have always been a very traditional thrift institution. We are the only thrift institution or bank I know of that can report absolutely no non-performing assets or real estate owned. Our largest loan has a 67% loan-to-value ratio. We have absolutely no loans outside of our local market area. Notwithstanding all of the difficulties and problems facing this industry over the last 20 years, we have never lost money. In spite of this record, during our last examination, we had a team of five examiners for 40 business days disrupting our operations. This process cost us over $29,000 in 1989 as compared to $16,000 in 1987, the year of our last examination, and resulted in absolutely no benefit to our institution, the supervisory process or the public. I view the examination process as critical to the integrity and long-term survival of the thrift industry. I do not believe the system is functioning properly, however, when an institution such as ours ties up five examiners for 40 business days and results in a report showing no significant problems or deficiencies. Incidentally, you

may be interested to know that the concurrent FDIC exam took 1 1/2 days to complete and also showed no problems or deficiencies.

c) *Eliminate the redundant and confusing SAIF and BIF insurance systems.* I do not see any advantage to maintaining the dichotomy between commercial bank and thrift institution insurance systems. The FDIC controls both funds and as I am certain this Committee is all too painfully aware, the real estate problems facing all financial institutions, both thrifts and banks, do not differentiate in their impact on individual institutions. I cannot discern any rational basis for maintaining the dual funds and believe that the public should not be further confused by SAIF insurance versus BIF insurance when it comes to their savings. If the government indeed stands behind its guarantee, then all financial institutions should operate on a level playing field according to risk. I believe risk-based premiums make a great deal of sense, (probably because we operate so risk-free), and believe risk-based premiums would be appropriate for both thrifts and banks. I note that the OTS has recently instituted a program of increased assessments for the weakest thrifts requiring the greatest supervision. This is a positive step in creating a fairer enviornment within which we can compete.

You have asked what additional regulations, if any, should be adopted. Prior to coming here today, I took the opportunity to briefly review the regulations governing the operation of national banks and compared them to the regulations governing federally chartered thrift institutions. While I don't claim to be an expert concerning either, it is immediately apparent that tremendous

philosophical differences exist in the regulation of national banks compared to federally chartered thrifts. The regulations governing national banks measure approximately 1/2 to 3/4 of an inch thick. The regulations governing federally chartered thrift institutions, however, measure closer to four inches thick. While this test is admittedly less than precise, the day-to-day regulation of a thrift institution is, in our view, entirely inappropriate. There are thrift bulletins and regulatory bulletins and operating regulations governing virtually every aspect and detail of how I try to run our business. Compliance with all of these regulations and bulletins has become not only a nightmare, but an impossible nightmare. As a relatively small thrift institution, I have three attorneys on staff and experienced outside counsel trying to keep track of our compliance responsibilities. There are so many regulations affecting our day-to-day operations that one of our biggest concerns is the violation of a regulation, thrift bulletin or regulatory bulletin that we don't even know about. National banks, on the other hand, have relatively little of this day-to-day type of regulation. The general parameters of their authority are set forth in the regulations and their daily operations are left to the discretion of management. The bank regulators are generally quick to move when management does not show the capability to operate in a safe and sound fashion, and we believe this general approach is preferable to the "big brother" approach which has been prevalent in the thrift industry. We believe the role of Congress and the regulators is to require adequate capital, provide adequate supervision and then

let competent management operate their institutions. OTS Director Ryan has indicated his approval of this approach, although his staff has not yet demonstrated their commitment to this philosophy.

2) WHAT CAN BE DONE TO SAVE THE TAXPAYERS MONEY IN THE RESOLUTION OF FAILED THRIFTS? I believe that the most important step that can be taken to save the taxpayers money in the resolution of the thrift crisis is a political step. That is, we cannot afford a failure of our political will. Congress has established the RTC as the agency in charge of cleaning up troubled thrift institutions. It is absolutely essential that Congress let the RTC do its job. The RTC must have adequate funds on both an overall and a cash flow basis to get the job done and the RTC must be free to do its job in the most cost effective manner possible. The current scenario is an impossible one. The RTC is hamstrung by inadequate operating capital, inadequate total capital and no political consensus as to the appropriate method of dealing with this tremendous problem. The RTC is being second-guessed in Congress every step of the way and is being required to announce its sales strategies and asset disposition strategies to the public before entering into negotiations with potential buyers. I read reports that hundreds of potential buyers are invited to bidders' conferences, yet the RTC generally receives very few bids for any particular institution. I speculate that some of the reasons for this are that the RTC is hamstrung in what it can offer potential bidders and that the value of the thrift franchise has been eroded so substantially that relatively few buyers remain.

I believe it is essential that the government not continue as the largest owner of real estate in the country. If there is anything we have learned from this crisis, it is that the government is the wrong body to manage this real estate. I believe that two things could be done to change this current scenario: a) sell as soon as possible the real estate and other assets which the government keeps when it disposes of the deposits of troubled thrift institutions. The longer these assets remain in government hands, the greater the carrying costs, operating costs, costs of supervision and costs of inspectors to supervise the supervisors. Ignore current real estate appraisals and sell the assets for what they will bring on the market; b) put assets in the hands of private buyers who are required to put up significant private capital, and give them incentives for working out the real estate at a profit and apply financial disincentives for working out the real estate at a loss. Whether tax incentives, cash or other consideration is utilized, we will have accomplished the most important goal, and that is putting these assets in the hands of private parties, with their own funds at risk, who will be far more adept at realizing greater value than has been the government.

I have one final thought in this regard. The cost of the thrift cleanup should be an on-budget item, should be acknowledged by Congress and we should not engage in any financial games in order to minimize the reported cost to the public. If we do so, I believe we will be guilty of the same fictions we have crucified thrift regulators for, and that is manipulating reality in order to make the situation look a little better. The thrift crisis is

the single biggest economic disaster in the history of our country and it must be faced and faced head on. We should do everything possible to minimize the cost to the taxpayer of our past mistakes, even if this includes tax breaks or other incentives to attract private capital to this effort. I do not believe we can let political concerns govern this issue. It is far too costly to deal with in that fashion. If we don't take dramatic action now in eliminating the government as the holder of substantially all of the assets of these failed thrifts, and if we don't let the RTC function with wide latitude in maximizing the value of these assets, I believe the ultimate cost to the taxpayer could simply become unaffordable.

3) **WHAT IS THE FUTURE OF THE THRIFT INDUSTRY? CAN INSTITUTIONS THAT HAVE STAYED WITH THE TRADITIONAL THRIFT BUSINESS OF MAKING HOME LOANS SURVIVE?** I believe there is an important niche in our banking system for institutions specializing in housing related finance. Our institution and many others are dynamic examples of how we can remain committed to our traditional role while operating safely and profitably. It is essential, however, to preserve the value of our charter through moderate flexibility and regulation. I also believe the thrift name has been irrevocably destroyed, and that we should no longer be required to maintain the stigma of being labeled a thrift. We need to identify a new name for our mission in order to eliminate the measurable adverse impact the thrift moniker has on our stock trading multiples and our ability as an industry to raise capital.

The value of our charter, with whatever name we adopt, must also be preserved in order to avoid unnecessary and unaffordable additional thrift failures and continue our role in funding the cleanup of the failed portion of the industry. The current image of a corrupt and incompetent thrift industry must be reversed.

Risk based deposit insurance premiums should be adopted in order to allow those of us operating in the most conservative manner to continue to compete successfully utilizing the lower profit margins obtainable on single family home mortgage loans. This will help preserve our franchise value and our role in the cleanup process, as well as facilitate our mission to provide affordable home financing to millions of Americans each year. Our industry has over 100 years of commitment to this mission, and I believe we are largely responsible for the high standard of housing we enjoy today. While other nations have become more prosperous than ours in many ways, none has surpassed our single family housing standards. I believe our long term commitment has made this prosperity possible, that this is an appropriate national policy, that success can be achieved without inappropriate risks to the insurance fund or taxpayers, and that the preservation of the value of our existing thrift franchises and the prompt and privatized cleanup of our failed thrifts are the keys to this success.

Thank you again for permitting me to express my views on these critical issues.

The CHAIRMAN. Thank you. I appreciate your strong interest.

Senator D'Amato, did you want to just make an opening comment, and we will move on to Mr. Shanahan.

Senator D'AMATO. Yes, Mr. Chairman.

In the interests of time, I would ask that my remarks be included in the record as if read in their entirety.

The CHAIRMAN. Very good. We shall do so.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Mr. Chairman, thank you for convening this hearing today to examine the condition of the savings and loan industry. I am pleased to welcome today's witnesses, Mr. Anthony Frank, U.S. Postmaster General and former chief executive officer of First Nationwide Savings and Loan of San Francisco; Mr. William Glencorse, chairman of First Federal Savings and Loan of Lenawee County, MI; and Mr. Edumund Shanahan, chief executive officer of Bell Federal Savings of Chicago.

I welcome the opportunity for the kind of exchange today's hearing offers us with those experienced in leading healthy thrifts, and so I shall be brief in my opening remarks.

Despite months of headlines about failed thrifts, there are some S&L's in the United States who have been guided in these last years by conservative philosophies regarding lending and capital requirements. These thrifts are surviving the current S&L crisis quite well, and we must hear their concerns and anticipate their needs just as we do those of the industry's poorer performers.

In particular, I look foward to hearing from today's witnesses their views of how the burden of assisting failed thrifts has been distributed throughout the industry as a whole; how implementation of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 has affected healthy thrifts, and if additional measures are needed; and how the public cost of the savings and loan bailout can be minimized. Finally, an assessment of the future of the thrift industry from today's witnesses will be most valuable.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Shanahan.

STATEMENT OF EDMOND M. SHANAHAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BELL FEDERAL SAVINGS AND LOAN ASSOCIATION, CHICAGO, IL

Mr. SHANAHAN. Thank you, Mr. Chairman.

It is indeed a pleasure and, frankly, a great compliment to Bell Federal to be invited, and I surely appreciate it.

I come representing an institution that has stayed in the traditional thrift business.

We not only survived but currently are experiencing earnings and financial strength greater than we have ever had before.

I do not represent any formal group.

I do come as a typical savings and loan association manager who has spent almost all his life in this business.

I was shocked in the early 1980's to see the actions taken by managers, many of them new to the business, taking control of

older institutions, making risky investments with funds attracted by very high savings.

In the formal testimony I submitted I gave repeated testimony that I gave before the House in 1985 in which I predicted the downfall of the FSLIC if rapid savings growth continued.

I have submitted a copy of that testimony at that time.

Bell Federal currently has 13 offices in the Chicago and Rockford area.

We are a $1.9 billion thrift. When I came into the business 32 years ago, we were the 13th largest in the United States.

Today we are the 125th largest because we always felt the safety of the savings given by our customers was much more important than rapid growth.

Frankly, we could be the largest thrift in the Chicago market at the present time, because 6 years ago we were offered the two largest institutions who were both in trouble.

We were also told that we could have forbearance, and capital ratios were something that we should not really worry about because that would be taken care of, and 5 years from now the problem will be solved.

We were not smart enough to take that advice, and fortunately we have stayed the size we are.

I have also submitted an article recently run in the Chicago Tribune which described us in more detail, and incidentally described Bell Federal's being stodgy.

We consider that a compliment.

I may sound much like my friend, Bill Glencorse, when I tell you what we do. We make one- to four-family loans, owner-occupied, 80 percent of appraised value, and our maximum loan—we are conservative, Bill—we only go $400,000. We do not have any $525,000.

We also have no problem with the 70-percent QTL, or loan-to-one-borrower limit because of that.

Our current net worth, as our good Senator from Illinois has already told you, is 8 percent, more than double of the current capital requirements, and at the present time is greater than any major Chicago area bank—greater strength.

And yet the S&L's are being lambasted as being in bad shape.

Bell remains strong by staying in the business we know: making home mortgages and keeping our operating costs down. We are not alone in this.

Every State in the Union has institutions of this nature, and surely Bill Glencorse's is an example, but there are many others that fall into the same category.

We are, however, a silent majority maligned by the public for actions taken by a very vocal minority who are either stupid, crooked, or both.

FIRREA placed a limit on junk bonds, loans-to-one-borrowers, and other assets.

Frankly, the real answer is the establishment of a strong regulator who has the authority to act when the next wave of risky assets appears.

History has shown that rapid growth has caused almost all of the problems. Institutions paying high rates had to get a high return

on their investment, and the old adage that rate is commensurate with risk applies, and it is going to apply every time.

FIRREA was a step forward.

Unquestionably there are things that could be changed, and I would be happy to answer detailed questions, but basically I would urge you to watch the danger of micromanaging asset limitations through legislation.

If you have a strong regulator, give them the powers and let them alone.

You are going to accomplish a lot more than trying to legislate the details because, as you are finding out, it just does not work.

One of the questions you asked is what is the future of the thrift industry?

I am not sure what you are going to call our industry.

You may change the name, but I do know that you will want home lenders who will serve the people of our country.

You and the other congressional leaders will continue to want specialists in home lending so that we can continue to house the people of our country.

Bell Federal and many other institutions through the country—and I emphasize this; we are not alone; I am not bragging as a single institution—but many others in every other, Senator Kerrey in your State and every other State have strong institutions, as well.

We are there in the business we know. We are not anxious to get into their business, and we will pledge to continue to work with you for our common goal.

I do not have in my script this information, but I have read the material submitted both by—and this is not done just because the gentlemen are here—but I frankly compliment you on the proposals you have in the recent legislation regarding insurance.

The answer again is not fooling around trying to drop the $100,000 to $50,000.

Believe me, with computers you can get coverage. You have to control the assets.

The variable rate insurance program is there. It's all in what way you do it.

Tony Frank will go into detail and has been an expert on methodology, but you must control assets.

Mr. Chairman, that sums my thoughts.

[The complete prepared statement of Edward M. Shanahan follows:

TESTIMONY OF EDMOND M. SHANAHAN, PRESIDENT & CHIEF EXECUTIVE OFFICER
BELL FEDERAL SAVINGS AND LOAN ASSOCIATION, CHICAGO, ILLINOIS
TO THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
SEPTEMBER 25, 1990

Thank you for the opportunity to testify concerning the condition of the thrift industry. I come before you representing an institution that stayed with the traditional thrift business throughout the past decade. We not only survived, but currently are experiencing record earnings and financial strength. I do not represent any formal group, but I do come to you as a typical savings and loan association manager who has spent most of his life in this business. I was shocked in the early 1980's to see the actions taken by some managers who formed new associations or have taken control of older institutions and then made extremely risky investments with funds attracted by high savings rates. In my testimony before a House Sub-Committee in February, 1985, I predicted the downfall of the FSLIC if rapid savings growth was allowed to continue. A copy of this testimony is attached (Exhibit A).

Bell Federal Savings is a $1.8 Billion thrift with 13 offices serving the Chicago and Rockford metropolitan areas. When I started in this business 32 years ago, we were the 13th largest in the nation. Today we are 125th largest because we have always felt that the safety of our customers' savings was much more important than growing for growth's sake. Bell Federal could be the largest thrift in the Chicago market if we had accepted the offer of regulators to merge Talman and First Federal when they had economic

problems in the early '80's. We were promised forbearance on our capital ratios and told not to worry because we could use "goodwill" to solve our problems. The attached newspaper article from the Chicago Tribune (Exhibit B) describes this proposed merger in some detail. As the Tribune said in its headline, we chose to remain "stodgy" and are most thankful for that decision.

Bell Federal limits its lending to 1-4 family units which are owner-occupied and have a loan amount no more than 80% of appraised value. Our maximum loan is $400,000, so we have no problems with the new 70% QTL test or loan to one borrower limit established by FIRREA. Bell's current net worth is 7.8% of assets, which is more than double all of the current capital requirements, and is greater than the net worth ratio of any one of the billion dollar asset commercial banks in the Chicago market.

Bell remained strong by remaining in the business we knew -- making home mortgages and by keeping our operating costs down. It is important to emphasize that we were not alone in following this philosophy. There are hundreds of similar thrift institutions in each of your states and throughout the country who have done the same. They are a <u>silent majority</u> who have been maligned by the public for actions taken by a very <u>vocal minority</u> who were either stupid, crooked, or both.

FIRREA placed a limit on junk bonds, loans to one borrower, and other asset restrictions which may help, but the real answer is the establishment of a strong regulator who has the authority to act when the next wave of risky assets appears. History has shown that

rapid growth has caused almost all of the problems that our industry experienced in the last decade. Institutions paying high rates had to get a high return on their investments, and the old adage still applies that "rate is commensurate with risk."

FIRREA was a step forward, but I believe there is a serious danger in micro-managing asset limitations through legislation. You must give the regulators strong powers and retain oversight to be sure that the powers are utilized.

One of the questions asked in preparing this presentation was "What is the future of the thrift industry"? I am not sure what you will name the industry, but I am sure that home lenders will always be necessary for a strong United States. You and other Congressional leaders will continue to want specialists in home lending so that we can continue to house the people of our country in a desirable fashion. Bell Federal, and the many hundreds of other institutions, wish to stay in the business we know. We pledge to continue to work with you to reach our common goal.

EXHIBIT A

HEARINGS
Before A
SUBCOMMITTEE OF THE
COMMITTEE ON
GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS
FIRST SESSION

FEBRUARY 28, 1985

STATEMENT OF EDMOND M. SHANAHAN, PRESIDENT, BELL FEDERAL SAVINGS & LOAN ASSOCIATION, CHICAGO, IL

Mr. SHANAHAN. Thank you, Mr. Chairman.

It is a privilege to come before you. It is the first occasion that I have had the opportunity to testify at a congressional hearing, and it is obviously very informative.

I do not represent any formal group. I come to you as a typical savings and loan association manager who has spent his entire career in this business.

I frankly have been shocked at the actions taken by a few managers in this business in recent years who have formed new associations or have taken control of older ones and in the past 3 or 4 years have made investment risks with high rate savings funds that would have been considered outlandish through most of my career.

I am here basically to denounce the myth that savings and loan associations must grow rapidly to get out of their problems. In the State I come from, exactly the opposite condition exists, and I will prepare to prove it to you.

Our institution currently has $1.7 billion in assets with 13 offices in the Chicago area. When I started 26 years ago, we were 13th largest in the Nation; we are now 87th; we will undoubtedly go lower as our goal is not growth, it is preserving the savings deposits and the capital that we have built up over the years.

We could be in excess of $10 billion right now if we accepted all the regulatory mergers offered to us within the last 3 years. We did not do so because our capital position would have been terrible had we taken such action.

We operate in a State that had no branching until 1973, and an extremely onerous usury law, and in general was not a State in which you could operate well in savings and loan business.

At the present time almost 50 percent of the institutions—in the State of Illinois—do not meet the 3-percent net worth requirement, even with the use of good will and all the other accounting gimmicks that come into play.

Because of these problems we have gone from 460 institutions 12 years ago to 270 at the present time; and believe me we are going to lose a lot more in the near future.

Why did Bell and some others remain strong while this happened?

Basically, we did it because we stayed in the business we knew: Making home mortgages. We did not get involved in a lot of proposals that came to us, investing throughout the country.

We intentionally restricted rapid growth. The associations who failed took just the opposite position.

We offer only single-family, owner-occupied ARM residential loans with loan-to-value ratio of 80 percent or less. We, obviously, obtain a lower return on our investment than an association that invests in commercial loans, equipment leasing, or junk bonds.

But we also have almost no real estate owned, and we are very comfortable in the turbulent economic conditions that exist at the present time.

As you might expect, we watch our costs quite closely. Our present operating expense ratio to total assets is 0.89—and the gentlemen in the business will know that is extremely low for our size, or really for any.

I do not come here to say that we are the only one. There are many institutions throughout the country—I think in most of your districts—that are operating in much similar fashion.

The institutions that have remained strong have avoided rapid growth, and have avoided many of the new powers that have been talked about today.

Bell Federal's net worth at the present time is 4.75 percent, and we have no good will, or any of the other accounting gimmicks that I referred to before.

We are aware that current deregulation structure would allow our institution to grow rapidly, if we wished, if we were willing to pay above-market rates for our savings and then turn around and invest them in extremely risky loans.

We do not think it is a good idea.

Again, I would like to point out, we are not alone. I would suggest to you that I represent a silent majority of this business: A lot of people throughout the country who are not for all these gimmicks. I was invited because I was considered one of the conservatives of the business. I think there are a lot like Bell.

There are only a few highflyers in this business, but they are causing tremendous problems for the FSLIC.

To give you an example, I present a quote from an individual who formerly operated by making home loans in his area. He turned around and started making commercial loans, commercial real estate loans with equity kickers and making them all over the country.

His quote was:

"If interest rates go down and the economy remains strong, we are going to make a bundle. If they don't, we will turn the keys over to the FSLIC."

Well, that may be a pretty good idea for him; but I would suggest to you that it is not a very good idea for us, or for any of the other institutions that are insured by the FSLIC.

I heartily endorse the actions that the Federal Home Loan Bank Board have taken to curtail the depletion of the FSLIC funds. Asset growth, direct investment power should not be available to institutions with limited capital.

If they have sufficient capital, it is perfectly fine, but be sure it is legitimate tangible net worth; not all these gimmicks that we are hearing about.

We are not anxious to have our premium increase from $1.2 million to $3 million as the one-eighth would do per year, but we realize that some action is necessary to build up the FSLIC fund.

The plan currently proposed by the U.S. League of Savings Institutions for a 1-percent assessment, I think deserves the attention of the Federal Home Loan Bank, and I hope ultimately the Members of Congress.

I applaud Chairman Gray and members Grigsby and Hovde for the action they are presently taking on a very serious problem.

I would also make the comment in the last day and a half we have talked a great deal. Your valuable time has been taken up about direct investments. I do not think that is a major problem at all.

I can blow up an institution with 20 percent direct investments, 10 percent, 5 percent, or zero. The major problem, and the one that I think is the most important action that the bank took was controlling growth.

Ultimately, you want to control the investments by controlling growth; the fast growth institutions are the ones that have caused the problem. That is the attention that I think is worthy of the Congress, and of our industry. We must get this back under control, because the FSLIC condition at the present time, in my estimation, is an absolute disaster.

The need for action is great; the savings and loan industry has provided homes for millions of families since the end of World War II, and I am sure we will be able to continue this vital function with your aid.

I will be happy to answer your questions, Mr. Chairman, at the proper time.

Mr. BARNARD. Thank you very much.

[The prepared statement of Mr. Shanahan follows:]

Bell Federal plays it safe
Bell Federal Savings and Loan proves that in a troubled thrift industry being stodgy has its merits. Sec. 4, pg. 1.

Chicago Tribune, Monday, July 30, 1990

EXHIBIT B

Tribune photo by Charles Osgood

"We only make loans for 80 percent of the value of owner-occupied one- to four-family homes," says Edmond Shanahan, head of Bell Federal Savings & Loan, which has resisted pressure to make 90 to 95 percent loans.

Bell capitalizes on conservatism

By Christine Winter

In 1985, Edmond Shanahan, chief executive and president of Bell Federal Savings & Loan, joined four other thrift executives testifying before Congress about the state of the industry and its insurance fund.

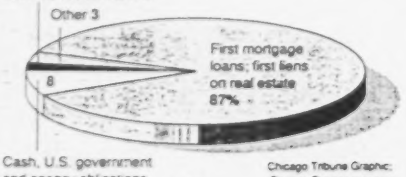
Shanahan said he was shocked by the "outlandish" practices of other associations that were growing rapidly through risky loans funded by high-rate deposits. He warned that the industry's insurance fund was an "absolute disaster."

His conservative stance contrasted sharply with that of his colleagues—and, in fact, seemed to irritate them. One said that if he had run his business the way Shanahan ran Bell, he would have been fired, and certainly "wouldn't have much to be proud about."

Today, those other four institutions—Lincoln Savings & Loan Association of Irvine, Calif.; Western Savings & Loan Association of Phoenix; Commodore Savings & Loan Association of Dallas; and Germantown Trust Savings & Loan Association of Germantown, Tenn.—have been taken over by the government.

Bell Federal Savings and Loan

Assets by type as percentage of $1.81 billion total for 1989


Non-real estate loans 2
Other 3
First mortgage loans; first liens on real estate 87%
8
Cash, U.S. government and agency obligations

Chicago Tribune Graphic; Source: Company reports

Shanahan's two sharpest critics that day were Robert Hopkins of Commodore, who was sentenced to 15 years in jail last year for diverting funds, and Charles Keating of Lincoln, who is fighting in bankruptcy court to salvage his empire.

Bell, on the other hand, is tangible proof that in some industries, being stodgy has its merits.

Bell reported record high earnings for the first six months of 1990. It has capital levels close to 8 percent, more than double regulators' strict new standards. In fact, Bell ranks in the top 10 percent of the nation's thrifts for all types of capital, according to Sheshunoff Information Services Inc.

Shanahan no longer minds being considered a Neanderthal. These days, he seems to relish Bell's out-of-step-with-the-times image.

"It has never been our goal to grow; we've always considered our capital ratio the most important thing," he said in an interview recently. "We weren't created to do commercial lending or speculate in land or buy stocks; that's not what we know how to do.

"We were often asked why we didn't open a mortgage subsidiary in California, like Skokie Federal and Concordia," he said. "Our answer is that we didn't think we were smart enough to compete with California institutions on their own turf."

In fact, Bell hasn't even put a local apartment building mortgage on its books in 15 years.

Some time ago, a Chicago banker, on hearing that Bell had declined to look at a failed thrift put on the block by the Resolution Trust Corp., shook his head sadly.

"I don't know what's the matter with those guys over there. How conservative can you get?" he asked.

The answer is pretty clear: about as conservative as they make them.

"We have concerns about

See Bell Federal, pg. 6

Bell Federal

Continued from page 1

dealing with the RTC, because Congress keeps changing things," said Shanahan. "We're doing very well by ourselves, so why get into it?"

Bell, which has 12 offices around Chicago and one in Rockford, made its last acquisition eight years ago, and typically its assets grow less than 5 percent per year.

Bell did have a lot of opportunities to grow rapidly. It could easily be a $6 billion to $10 billion institution these days, instead of $1.8 billion.

According to Shanahan, Bell was called in by regulators in the early 1980s and asked to absorb a number of troubled thrifts, including Talman Home Federal Savings & Loan and First Federal Savings, before Talman itself was merged with four others. But Bell's management didn't like the sound of the deals, which "just didn't seem to make sense to us."

Shanahan sighs with relief today that Bell, despite losses during the tumultuous surge in interest rates in the early 1980s, was in a strong enough position to be able to turn down the regulators' proposals. The institutions that grew rapidly through such regulatory mergers are virtually all burdened with worthless good will now and have become capital-deficient under the new standards.

But that same conservatism has brought Bell into conflict with a local community group, which torpedoed Bell's recent attempt to make a rare acquisition, of Archer Federal Savings & Loan Association. They based their complaints on Bell's lending practices in low-income neighborhoods.

After negotiations with the group, which included a march on Bell's Monroe and Clark Street headquarters, the sides have reached an impasse, Shanahan said. As a result, Bell has dropped its acquisition plans.

"We only make loans for 80 percent of the value of owner-occupied one- to four-family homes," said Shanahan adamantly, adding that community groups were requesting a program of 90 to 95 percent loans. "It's difficult to change your standards in one neighborhood and not another. We've always felt that an S&L loses money on 90 percent mortgages."

Bell, of course, has no exotic sources of funds, either. It has no out-of-state or brokered funds, known in the industry as "hot money."

It still has 15 to 17 percent of its deposits in passbook accounts, with the rest in checking accounts and certificates of deposit. Studies indicate that the average Bell customer is close to retirement age, part of a group Bell likes to call "young seniors."

"We've never paid the highest rates, but our customers are loyal," said Ken Wagner, senior vice president. Consequently, Bell felt it would be unfair to drop its passbook rates when bigger thrifts went that route last year.

Although its own standards are generally stricter than any imposed by the Financial Institutions Reform, Recovery & Enforcement Act of 1989—Bell won't make a loan of more than $400,000 to any one borrower—the 65-year-old thrift has not gone through the recent crisis unscathed.

Its yearly premiums on deposit insurance are now up to $3 million in pretax dollars, and with today's negative perceptions of the industry, even Bell customers are skittish.

Wagner said that when recent remodeling began in the lobby of its headquarters, Bell had enough calls from worried customers who feared a takeover was underway that signs were hurriedly placed in front of the building explaining the renovations.

And even though Bell appears to have few worries in an industry bursting with Excedrin headaches, Shanahan said it will maintain its hard-line stance about how a thrift should operate.

"You can never be too strong in this environment," he said.

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The CHAIRMAN. Well, thank you. That is, again, a very important and valuable contribution that you have made.

You know, that speech was very insightful and forward-looking that you gave in 1985 on the House side. It seems to me like we should have had you over here on the Senate side. [Laughter.]

At least we have you here now, and that is a plus.

Senator DIXON. Mr. Chairman?

The CHAIRMAN. Yes.

Senator DIXON. Before you recognize my good friend from Nebraska, may I make a quick comment because, as I already mentioned to my dear friend Ed Shanahan—and I apologize to Mr. Frank and Mr. Glencorse—I do have to leave here right now because our distinguished mayor is in town and I have some city matters to support.

Mr. SHANAHAN. Give him my best.

Senator DIXON. I will do that for you, Ed.

But I do want to comment after hearing these marvelous recitations from Mr. Glencorse and Mr. Shanahan that that is a message that ought to go out to the public: That there are plenty of sound institutions in this country with honorable men and women in them that acted as reasonably prudent people in what they did over the years.

Had the regulators done the job they should have done with the crooks and those that wanted to take outrageous risks, we would not have this problem today. People like Mr. Glencorse, and Mr. Shanahan, and Mr. Frank who conducted themselves correctly and made the right kind of loans are still in good shape.

That is a message I think for the country, and I hope, and may I say this to all of you, I hope in the legislation that we undertake to pass in the next Congress we will address the sensible aspects of it without macromanaging you, Mr. Glencorse, and get some changes in the insurance law, and see that people are adequately regulated and supervised so we get rid of the rascals and protect the institutions in the country in that way.

I am just sorry, Mr. Frank. You are going to be talking about some things that my friend from Nebraska has been advocating for a long time, incidentally. I have read your stuff and it is very good, and I am glad my friend from Nebraska is here.

Forgive me, Mr. Chairman, for leaving.

The CHAIRMAN. Not at all. Those are very important comments, Senator Dixon.

Senator Kerrey, let me invite you to make any comment that you wish before we go to Mr. Frank. We are delighted to have you join us this morning. I mentioned earlier that you would be coming.

Senator KERREY [Nebraska]. Thank you, Mr. Chairman.

I would just state what I think is the central problem with trying to deal with the range of things that sit in front of us as policymakers.

Mr. Shanahan, I heard you suggest that what we need is a stronger regulator, and then to essentially leave them alone. The problem, or the dilemma actually in a representative democracy is that we cannot do anything unless we get permission from the

people to do it, and that is particularly true when it comes to spending.

I have heard it represented by a number of smart people that had Congress just appropriated the money several years ago, why we could have spent a great deal less on this particular problem. That is easy to say. It is not easy to go to the American people and get their money for any sort of thing today, or any time for that matter.

We have to think about the dollars that we are spending. I must tell you that I am fearful that the American people are not going to give us permission to spend the amount of money that Mr. Siedman has requested from both this committee and the House side. $122 billion next year is a lot of money.

Given the track record thus far in forecasting the amount of money that is needed, which has not been good, there are suspicions of some of us that that may not be enough; that that may be ratcheted up another $40 or $50 billion.

Well, I get my permission from the people of Nebraska to move. I saw the creative suggestions that many House Members have made for how to get that $122 billion. I mean, it is everything up to and almost including getting Saudi Arabia to pay for it, and that suggests that in fact they are sensing the same thing; that what has happened is a breakdown of trust.

The American people just do not trust that we are doing it right. So to simply say we are going to give it to a strong regulator and have them do the job right I do not think is going to work.

Somehow we need to look for an arrangement where the people are going to say: We trust that we are being told the truth. We trust that the information is accurate. We trust that you are making decisions not based upon what you think it will do for you politically, not based upon what you think is the most palatable politically, but based upon what is right.

I am fearful in fact that we are not too far away from a point where we find ourselves saying we do not have permission from the American people to do what we believe in fact is the right thing.

The CHAIRMAN. Thank you, Senator Kerrey.

Mr. Frank, we appreciate the good public service you give each day. We do not have the occasion to see you here often, and we are very flattered that you are here today, and I am very interested in your thoughts.

STATEMENT OF ANTHONY M. FRANK, POSTMASTER GENERAL, FORMER CHIEF EXECUTIVE OFFICER, FIRST NATIONWIDE SAVINGS AND LOAN, SAN FRANCISCO, CA

Mr. FRANK. Well that is very kind of you, Mr. Chairman, Senator Kerrey.

I do find myself in a somewhat anomalous position. Somebody will say in the article tomorrow, "Doesn't he have enough to do?" [Laughter.]

He is giving free advice on the savings and loan business, but I have been in the business 30 years and First Nationwide is the second or third largest in the country, and it is making money, and it has nonperforming loans of less than 1 percent. It has grown a

hundredfold almost since I started there. So I think there are some lessons to learn, as you say, from small, medium, and large.

My message is simple and ugly. We are in a national emergency. We are in a national emergency, and we are not acting like it with respect to this savings and loan matter.

As I said in my paper, my definition of a "national emergency" is something that, if it goes wrong, can adversely affect the course of this country, and I believe the savings and loan matter is that important in conjunction with other events.

There are a number of reasons we are not acting like it. One is that it is difficult for the public to relate to hundreds of billions of dollars. They can relate to $600 hammers and $700 toilet seats, and nickel increases in stamps. I found out they are very good at relating to that. But hundreds of billions of dollars is very hard for people to accept.

Second, I think there is a feeling that FIRREA will solve the problem. There are a lot of good things about FIRREA, and I admire the President and the Secretary of the Treasury and the Congress for passing it. As another witness said today, it did do some very good things. But it dealt with the situation as it was in 1989, and a lot has happened adversely since 1989.

The real estate market has sunk. Economic activity has ebbed. Publicity has increased. And, frankly, the problems that it sought to solve in 1989 are different than when I was at the signing 13 months ago.

And the last reason that we are not acting like it is—I hope this does not sound like a criticism—Good morning, Senator Kerry [Mass.]—is that there is a fascination with the past here, and everybody wants to punish the evil doers, and I think that is fine, but it is not nearly as important as moving ahead to solve our problems.

What do we need to do? We need to act as we always have in a national emergency. We need commitment and unconventionality. We need, I believe, a private board of directors of the RTC, much as Senator Kerrey's bill, I believe it is No. 2155, proposes.

The CHAIRMAN. When you say "private," you mean private-sector people? You do not mean public employees?

Mr. FRANK. Yes. Private sector people chosen from the very cream of the business community of people that would be willing to give full time at the start, and then an awful lot of time later.

I believe that that board obviously would have oversight responsibility to you and to the House, but it would develop a blueprint for how to solve this problem.

I believe one of their first acts would be to appoint a word that we do not like in this country, but a czar. That czar is going to have to cut through turf, and agency difficulties, and is going to have to come to grips with some matters. Let me just point out what those matters might be:

In contrast to the remarks by Mr. Glencorse, and I would say that one of the most admirable things about Mr. Glencorse is that he has no experience in foreclosed real estate, and my hat is off to him; I have had experience in a lot of foreclosure situations, and not all real estate should be sold immediately.

Hundreds of millions, if not billions, of dollars can be saved by holding certain types of real estate off the market, as we did in the 1930's in the HOLC when indeed the property was held off the market and a dividend was paid to the American people because the property was held off.

Well, that takes courage and judgment and good people, not something that is in ample supply at the RTC for a lot of good reasons at the present time.

I believe we need open thrift assistance. When we close a thrift or a bank, the losses I would say quadruple from what they are when you keep it open. That does not mean with the same management or the same capital. You have to put capital in. But keeping it open really saves a lot of money.

I believe that czar would pay private-sector wages to private-sector people to run the place. I would make some other suggestions, if you would permit.

One is, we need capital in this industry. The capital can come from two places: individuals and corporations. I think we need to take a look at the tax laws of this country and make it logical and profitable for individuals to invest.

The CHAIRMAN. Can I interrupt you just for a minute? I think it is very important. I want to back up.

Senator Kerry came in as you were starting, and also Senator Heinz has just joined us. I think you have just said some things that are important for them to be aware of, and I just want to take a minute to do that, and I will paraphrase.

Mr. Frank, who headed First Nationwide for many, many years prior to coming in as Postmaster General, has said that he thinks we need a whole new structure—and let me say this as well to Senator Sanford, because I know he has a great concern as well as to whether things are just getting away from us here in terms of the financial perversities of the present time—but Mr. Frank has just said that he thinks that we need a private-sector czar, or a private organization established to get on top of the implementation of the savings and loan problem and the disposition of real estate problem, and that there are tens of billions of dollars at stake. I am adding that. You did not say that, but it is the clear inference of what you were saying.

And, that we need an entirely different, streamlined mechanism to cut through this problem, or this problem threatens to consume us, or do great damage to the country.

So if I might, could I just ask you in a paragraph or two to restate that in the presence of the three additional colleagues that are here?

Senator HEINZ. Mr. Chairman, may I just add something to what you have said, and claim a couple of minutes of my opening statement time?

The CHAIRMAN. Sure. Yes, indeed. By all means.

Senator HEINZ. If the witnesses will forgive me.

In going over today's written testimony, I noticed that one of the witnesses complained that it is simply not fair to make the healthy segment of the thrift industry pay a disproportionate share of the burden. There is an important issue of fairness to be raised, but in my judgment there is nothing more unfair than making the inno-

cent American taxpayer pay the multibillion dollar bill to clean up the S&L industry.

In the upcoming conference with the House of Representatives on the omnibus crime bill, the Senate passed some legislation that will really help, that will put the Federal Government at the head of the line when it comes to recovering funds from those who looted savings and loans.

The Senate crime bill would make it impossible for people who are corrupt and who have looted the S&L's to shelter their income or their assets behind personal bankruptcy. We have a measure that a number of us worked on to take the trial lawyers, the junk yard dogs of the legal profession, and turn them loose as bounty hunters on those who defrauded the Government.

The problem is that the Senate passed those provisions, most of them, twice. During FIRREA, these provisions were rejected by the House, and every indication is that that is happening again. If that legislation is not acted on affirmatively, it will tell me that the House of Representatives has decided that the American taxpayer ought to be stiffed and that the S&L crisis and scandal is going to continue.

Mr. Chairman, I thank you. I just wanted to put that pitch in for the Senate's provisions, because I think these provisions have not been taken as seriously by the House. But the American people take this issue to heart, and I hope the message will be heard on the other side of the Capitol.

The CHAIRMAN. Thank you, Senator Heinz.

Let me just invite Senator Kerry and Senator Sanford also to make a comment at this point, and then I want to come back and tee up your main point, Mr. Frank.

Senator KERRY [Mass.]. Mr. Chairman, I appreciate that very, very much. I appreciate it particularly because I have an 11 o'clock and I have to preside over the Senate. I apologize to Mr. Frank for that.

But I wanted to come by because I wanted to emphasize, having seen your testimony, how important I think it is today. We have been learning in dribs and drabs how this problem is one day bigger, the next day larger, the next day not so large, and then there is another surprise. The auction was canceled last week.

The week before we heard in this committee's testimony about $70 billion of additional problem in the ways in which people have been bilked.

I am glad to hear somebody talking the truth and calling this the national financial crisis that it is, and it ought to be treated that way. I associate myself with the remarks of the Senator from Pennsylvania.

Many of us have been looking at ways to do more to try to restructure this, not just to sit here and throw out comments of dire circumstance, but to say where do we go from here?

I have been wrestling with the question of a restructuring. Senator Bob Kerrey has an approach and I have been wrestling with whether that is the way to go, or whether I prefer the approach of Bert Ely who suggests that we have a combination of the FSLIC-RTC, et cetera, put them all under Treasury and get the FDIC out there doing what it traditionally did with unappropriated funds,

and so forth, and separate the appropriated and unappropriated. Something. One of the two I think we have got to do.

Maybe you will address that in a subsequent question. I would like to ask the chairman for permission to have questions submitted in writing, but I cannot emphasize enough how I think the administration has a political cloud over this, how information is not forthcoming to the Congress, how information is not forthcoming to the American people, and how we are really playing with fire in a most dangerous way.

We have got to come to grips with it and, Mr. Chairman, you have been trying to do that. This is probably the busiest committee in the Senate now with these weekly hearings, and I think it is important but we have really got to resolve that.

I am glad my colleague, Bob Kerrey is here. Last week I attacked the question, and we went after the issue of the $70 billion, and I was glad to see that out in Los Angeles Senator Bob Kerrey had done it all. [Laughter.]

So today he came so we could really confuse people and make it happen better. [Laughter.]

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Kerry.

Senator Sanford, did you have a comment?

Senator SANFORD. I think I can contribute more by listening, but would like to say that North Carolina S&L's were by and large well run and run conservatively. I am very much concerned not only that we clean up this mess, but that we do not destroy what I think has been an extremely valuable institution for 50 years and more.

I welcome the testimony that looks forward to how we can keep the well-run institutions profitable and their charters viable.

Thank you for being here.

The CHAIRMAN. Very good.

Now, Mr. Frank, if I can, after us interjecting for multiple purposes, but I would really like you to recap if you would the thrust of your main point so far.

Mr. FRANK. If we have a national emergency, we have to act like it. That means not just providing "an" answer to "a" problem, but really acting as we did in the Manhattan Project in the Second World War, and in some of the other crises that have faced us.

That means taking some risks.

There is no incentive for risks right now. There are very able employees of the RTC who are terrified of doing anything out of the norm because when you do that you are either going to be horribly wrong, or wonderfully right, and there is no benefit for being right.

We need to get some courage. It is not working well, what is happening. Let's face it.

At first we see a statement that there will not be any auctions. Then we announce an auction and the auction is canceled.

We are going to sell servicing. We are not going to sell servicing. We are only going to close institutions. Maybe we will keep them open.

It is not going very well, and it is not Bill Seidman's fault. He is a great man and it is wonderful that he is doing it, but we need a different system from what is happening now.

Otherwise, this infection of sick savings and loan, Senator Sanford, is going to spread to your healthy institutions, and the healthy ones like the two these gentlemen represent.

We need to have a private sector board that will spend full time at it.

I am talking about the most notable people in the United States. I am reluctant to name names, but there are some notable people—12 or 14 people who would work initially full time, as they would if they were asked by the President to work on any other national emergency.

They would submit a blueprint to this committee and its comparable committee in the House, and hire a czar, and cut through some of this turf and difficulty and get going at unburdening us.

One of the things that they will do will be to not sell all the real estate—not sell it all—and not close all of the institutions; but, rather, to get capital.

Really all you need to run a successful savings and loan is management and capital and time.

This committee can give institutions all of that. Capital can be gotten from individuals. Call them "doctors and dentists," call them people that are susceptible to tax advantaged investments, we can get capital back in this industry from passive investors individually if we have a capped—no more than 6 or 8 percent tax—benefit to people, without any cash return.

We are not attracting investors in this industry. I believe that every recent sale of a savings and loan has been in pieces to another savings and loan or a bank.

In point of fact, we have not gotten any private investors since 1988 in this industry, and it reflects the absence of the value of the charter. I will speak about that in 10 seconds.

The other source of capital would be from large corporations. My old company is owned by Ford Motor Co.

They have strengthened it in terms of management, in terms of capital, in terms of reputation. There are other large corporations in this country that are spending their money by buying in their own stock.

I suggest that there are better things that they can do, and we need to make it easier for them to buy not banking companies but housing finance companies, which I consider to be quite different.

The charter has no value right now, and that is hurting the RTC's ability to sell. One of the reasons it has no value—and I know this is a very controversial point—is the fact that it is impossible for a savings and loan to hold bread-and-butter mortgages in its portfolio.

It is said, reliably, that 86 percent of the mortgages under $185,000, and that would be a house value of one-quarter of a million dollars or less, are bought by the Government, the Federal Government, through its mortgage entities.

So there is no ability for savings and loans to hold small, safe, local mortgages. So why would anybody buy a savings and loan?

The answer is, they don't.

There are a number of other things that we can do to improve the charter for savings and loan, but I also want to echo Mr. Heinz' point, as I understood it, that there is much we can do to help the RTC get around State regulations. Some States require a 2-year foreclosure period.

I believe that an examination of RTC would show, through no fault of their own, that 80 percent of the assets that they have are not available for sale because they have some sort of cloud on them in terms of legal action or foreclosure.

This committee, I believe, could work on legislation that could make it easier for the RTC to own the property underlying the bad loans, and to sell them, and to cut through local zoning and building ordinances and so on.

This is a national emergency.

I know we have a dual system in this country, but we have a national emergency and we need to act as though we do.

So we need to push.

Last, I believe that if there were no savings and loan industry we would have to reinvent it, and that is exactly what I am proposing.

The American people, and particularly the middle class, need an institution that deals exclusively with families, does not deal with corporations, does not deal with junk bonds, does not deal with all the international loans that commercial banks can and should do.

So as this industry goes away, we need to have a specialized financial intermediary that deals exclusively with families, and almost exclusively with their mortgages, plus their other business.

What it is to be called, I do not know. "Retail bank," "family bank," "savings bank," "consumer bank," one of those four, and I am sure Ed would accept any one of the four.

This committee has it in its power to think about what the structure of financial services would be well into the next century. It is clear to me that we are moving toward being the only Western country that does not have a specialized financial intermediary that deals with families—the only one in the Western world—and indeed we are the only one where all the mortgages go to the Federal Government.

I do not think the rest of the world is out of step, that everybody is out of step but us. We are the ones that are out of step. We ought to be taking a look at how we serve America's families with a specialized, local if possible, well-capitalized, well-managed, circumscribed financial intermediary that can serve the families that need service so much. Thank you for accepting my statement.

[The complete prepared statement of Anthony M. Frank follows:]

Summary Statement of Anthony M. Frank
September 25, 1990

You have asked me here to discuss ways in which the costs of the savings and loan problem can be reduced, as well as asking for my views on the provision of financial services to the American people in the future. The Congress, through this Committee, has the opportunity to save billions of dollars, as well as to structure the delivery system for financial services to middle America for decades to come.

The cost and complexity of the resolution of the savings and loan problem is so high now--so much higher than when FIRREA was signed by the President 13 months ago--that it constitutes a genuine national emergency. The savings and loan situation has the potential, in conjunction with other events, to make our nation into a second-rate power. Traditionally, our country has responded with different rules and different attitudes to the resolution of a possible national emergency, than it has to merely providing "an answer" to a "problem."

This is just such a time which requires a response with a different focus and with the zeal necessary to meet the crisis head on.

Simply put, there just is not sufficient private sector involvement, and insufficient authority to cut through the enormous complexity of dealing with this financial calamity. A private sector board, given broad authority, could, I believe, save tens of billions of dollars of taxpayer money by making difficult decisions on which institutions to close, which institutions to keep open (with matching private sector capital contributions), which real estate to sell, and which real estate to keep or even to increase the investment in the property. This can only be done by a super-prestigious hard-working board, subject to oversight by the Congress, and reporting either to the President or to the Secretary of the Treasury. I believe this board would seek to appoint a "czar" who would have the authority to cut through regulations, turf problems, and who would have the stature to make judgments involving billions of dollars that cannot always be correct.

Other actions that can be taken to minimize costs include developing means of securing capital from private individuals, via tax incentives, and making it easier for over-capitalized large American corporations to acquire savings and loan associations. Open institution recapitalization should be encouraged, as closing an institution appears to maximize the cost of solving that problem. Finally, this Committee could study means whereby the RTC could secure control of the properties underlying its problem loans more quickly, and could develop a dispute resolution system whereby local zoning, building, and foreclosure laws could be resolved.

While the chips should fall where they may for the savings and loan industry, its management and its shareholders, the function that it performed is essential and is now atrophying. It is increasingly apparent that numbers of branches are being reduced, absentee ownership is being introduced, and the gamut of services and prices available to the public is in a downdraft.

The charter for "promoting thrift and establishing home ownership" should be made valuable again, in order to maximize income to the RTC and in order to serve the American public for decades to come. This country is swiftly moving to be the only Western nation in which there is no specialized financial intermediary dealing in family mortgages and family finance, and in which over four-fifths of the middle class mortgages being made are being purchased by federal secondary mortgage market entities. This is not the way to go, yet the trend is accelerating.

While it is understandable that the reasons for this collapse should be understood, and it is certainly proper to seek restitution from owners and managment that fraudulently caused losses to the taxpayer, it is now time to turn to the twin tasks of minimizing the costs of the collapse, along with developing guidelines for the provision of financial services in the future. In this extraordinarily difficult arena I hope I have been helpful in offering concrete ideas that will enable the Committee to get over the anger and frustration of the situation, and deal with the consequences as inexpensively and as solidly as the American people expect.

Anthony M. Frank
September 25, 1990

TESTIMONY OF

ANTHONY M. FRANK

BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING

AND URBAN AFFAIRS

SEPTEMBER 25, 1990

Thank you, Mr. Chairman, and members of the Senate Banking Committee for asking me to present my views on how the cost of the federal government's responsibility to the depositors under the Federal Savings and Loan Insurance Corporation can be reduced, as well as requesting my comments on the provision of financial services to the American people in the future. It is my assumption that I have been asked to testify because of the fairly unique situation in which I find myself--experience with how government operates, a 30 year successful career in the savings and loan business, coupled with no personal ax to grind that I can discern. My background in banking and financial services is attached to this statement; I am proud of the record of First Nationwide Financial and First Nationwide Bank under my leadership and since.

A NATIONAL EMERGENCY

The magnitude of the cost of meeting the FSLIC responsibility, no matter what it finally turns out to be and how it is calculated, constitutes, if not resolved, a true national emergency. My definition of a true national emergency is an occurrence that can adversely change the course of our great nation. The next words are the most difficult that I have ever spoken or written in my life, yet I believe it is important to put them forth--the savings and loan situation has the potential, in conjunction with other events, to make our nation into a

second-rate power. That is an ugly, unacceptable prospect. It shapes the thrust of my testimony here today.

The general public has difficulty in relating to billions of dollars of loss. It is much easier to understand and rail against $600 toilet seats and $500 hammers and, yes, 5 cent increases in the cost of postage! Yet, students of government know that the real impact of the cleanup will be in social programs forgone, taxes not lowered (perhaps even raised), interest rates not lowered (perhaps even raised), as well as loss of international financial power for our country and its major institutions.

Equally impacted will be the way the American people are able to conduct their financial transactions in the future. Towns, cities, states, and even regions will undergo drastic changes in the ownership and accessibility of the financial institutions serving them, as well as in the quantity and quality of those financial services and the stringency or ease of loan availability; added to this is the adverse impact of the dumping of tens of thousands of real estate properties upon an already over saturated market.

Clearly, then, this is a true national emergency, and we need to attack it with the same zeal with which we fought World War II, pursued the Manhattan Project, overcame the 1973 energy crisis, and recovered from the Great

Depression. As with those monumental national emergencies, commitment to success is essential, as is identification of the key steps and methods--my task today.

FIRREA WAS A GOOD ANSWER, IN 1989

Much has changed since I attended the signing by the President of the Financial Institutions Reform, Recovery, and Enforcement Act in the Rose Garden in August of 1989. The problem has clearly become bigger than anyone then dared to imagine. William Seidman, then the only employee of the Resolution Trust Corporation, has performed ably in dealing with a steadily worsening situation in more difficult economic times, in a fish bowl. Public and legislative scrutiny have increased enormously, as has the political understanding of the dangers and costs of this situation. Real estate markets have worsened, in some cases dramatically, since the signing of the Bill some 13 months ago. Bidders for problem associations have been few and far between, and the number of problem associations has increased. To put it bluntly, while I am filled with admiration for the action by President Bush and Secretary of the Treasury Brady in dealing so promptly with this matter, and while I applaud the courage and speed of the Congress in approving the Administration's proposal, that proposal did not contemplate a national emergency, and that is what we now have.

FIRREA represents a sound Congressional reaction to the 1989 situation. It mandated sound capital requirements for the industry and more comprehensive regulation and supervision of the industry, as well as encouraging the prosecution of those who operated outside of the law. It clearly stopped any public concern about the safety of their deposits in the insured institution. I would, however, like to see the Act changed to transfer to the private sector the responsibility for the least expensive disposition of weak, failing, and failed institutions.

NEEDED--A PRIVATE SECTOR BOARD

I would like to suggest that responsibility for the administration of the financial consequences of cleanup, as well as for the regulatory aspects of failing or near failing institutions, should be given over to a blue ribbon board comprised exclusively of private sector individuals, reporting either to the Secretary of the Treasury or to the President of the United States. Of course, there would and should be Congressional oversight of this board, which would replace the present Oversight Board. The board, under Congressional authorization, would establish a blueprint for how to deal with this situation, including hiring and compensating management, contracting, setting merger and real estate sales parameters, as well as using directors' judgment with respect to such matters as open thrift assistance and holding real

estate off the market. As stated, this board would and should be subject to annual oversight hearings, before this Committee and its counterpart in the House, on its revisions to the blueprint, and the effect of the policy blueprint on the operations of the RTC.

Who should be on the board? I can think of certain essential attributes--members should have extensive broad business experience and excellent reputations; anyone who campaigns for the job should be automatically ineligible; and members should be prepared initially to work full-time and less thereafter, but they should continue to see this as a major personal commitment.

TIME FOR A CZAR

With their business experience, I belive the board would appoint a "czar," with broad powers to act, and stature to interact with all agencies of government. Diffused authority and competition for turf are "normalcies" that cannot be accommodated if the emergency is to be overcome.

SOME SPECIFIC SUGGESTIONS FOR SAVING MONEY

Having set the beginning of a framework for solving this problem, I have some specific comments on various aspects of the present situation.

The definition of a healthy thrift, I believe, is a highly regulated institution, with at least three percent in core capital, that is efficiently serving its local

market with non-corporate financial activities; it has predictable recurring income, primarily from mortgages, has honest, responsive and tested management, and has less than three percent of assets in non-performing assets. In order to convert current and future savings and loan problem cases into "healthy" thrifts, capital, management, time, and assistance are essential.

As I understand it, the RTC is now essentially saying "if it is sick, close it; sell the good parts to the highest bidder, and sell the bad parts as quickly as possible at the best possible obtainable price." That may be the way to deal with "a problem" but it is too cookie-cutter and will fail to solve this national emergency.

The financial effects of closing an institution are demonstrably ghastly. Earning assets are marked to "appraised" market, skilled people leave, customers go elsewhere, the "going business" value is quickly dissipated, and therefore billion dollar horror stories are quickly exhibited to the public. Open bank assistance has worked well in the commercial bank arena. It should be used, thoughtfully, in the thrift business. Such assistance, predicated on matching capital from new investors, and with new management, if called for, would represent a reduction in the cost to the taxpayers, I believe.

MANAGEMENT

Other than time, the two items most in short supply are management and capital. The scarce resource of management can be maximized by merging institutions, so that the same management team can oversee a bigger operation. The cost savings of merging institutions can be on the order of one percent of assets per year--in itself a considerable benefit in reduced costs to the taxpayer. Good management in the savings and loan business, as in any business, is scarce, and these scarce assets need to have contracts, be well paid and incentivized--the return on the expenditure will be astronomical.

CAPITAL FROM INDIVIDUALS

Without adequate capital, a resolved thrift merely becomes a "roundtrip" problem again--which has already occurred several times. Since the end of the tax break at year-end 1988, there have been very few individual or corporate investors attracted to the industry. Those few who do buy problem institutions are seeking both a guaranteed income and a very high return on their investment. I suggest that tax-motivated individuals can be attracted to put substantial passive real capital into this industry without requiring any cash return on their capital, merely by reinstituting a capped tax-benefit flow-through to an investor in a designated institution. I know it represents a policy reversal to start giving tax benefits to

passive investors again, but isn't a maximum six to eight percent tax benefit (plus a possible capital gain if the institution becomes valuable again) much cheaper than cash-on-cash returns of possibly 20 percent or more annually? Hundreds of millions of dollars, if not billions, of passive investor funds can be attracted to this industry with a judicious tax policy, just as we built sufficient rental housing for this nation in the 1970's by offering tax benefits to the same class of investor.

CAPITAL FROM CORPORATIONS

While the nation's banks and savings and loan associations are clearly undercapitalized, many of the great corporations of our country are so overcapitalized that they expend billions of dollars a year to buy back their own stock. Large corporations should be encouraged to purchase thrifts. Such encouragement could include waiving diversified savings and loan holding company provisions, simplifying tax benefits and tax sharing agreements, and easing non-egregious interlock prohibitions. Companies such as General Motors, General Electric, and many others do not own a thrift even though they are heavily involved with financial services. It would take a White House or Treasury task force less than a week to learn from major corporations what it would take to motivate them to acquire thrifts, thereby combining commerce and housing finance.

REAL ESTATE

Real estate, even in the best of times, is one of the most difficult assets to manage. There are properties that need to be sold or written off immediately; but there are many situations in which additional money put into the property will give the greatest return. This is basically a matter of experienced professional judgment that is difficult for the federal government to attract. Equally difficult is the realization by the high quality employees of the RTC that if they deviate from the norm, they can be gratifyingly right or horrendously wrong. If wrong, they will be hearing from you and the media. The only way for the RTC to minimize criticism is to sell all real estate properties immediately, in bulk, or through brokers, or at auction. The enormous losses generated by such a policy can be reduced by investing in and holding property rather than dumping (particularly in an over-saturated market); however, this approach involves risk, possible censure, and courageous uncommon judgment.

In my personal experience as a public interest director in the first major bankrupt association in 1967, and later in the nation's first management consignment program, at the failed Beverly Hills Savings, I saw vast sums of money saved for the federal government by holding and investing, rather than pushing the real estate out the door to opportunistic "bottom-fishers." However, only a

private board comprised of people in whom you have confidence could promote such private sector initiative and risk taking in order to minimize the financial impact on our nation and on the real estate market of the affected area of the country.

Two more suggestions to save money:

First, the savings and loan charter must be made valuable again, otherwise no one will pay a going business value for the associations put up for sale. Recently the National Association of Realtors testified that HUD had indicated that 86 percent of the nation's conforming conventional loans--healthy loans originated by healthy institutions--are being federalized, by purchase of these loans by federal secondary mortgage market entities. That leaves very little that is profitable or desirable for an association to hold in portfolio. There are solutions to this problem, including reducing the maximum loan amount that can be purchased, or by a sophisticated program of layering mutliple lenders on one mortgage, as is done in France. Should the federal government be purchasing virtually all the loans made on homes of a quarter of a million dollars or less, at the same time forcing traditional portfolio mortgage lenders into riskier and riskier niches? Clearly not.

Again, there have been other items that have lessened the attractiveness of the charter: capital requirements

have been raised, insurance premiums have been raised, the range of profitable investments has been reduced, and the cost and quantity of supervision and regulation has been elevated--scarcely a menu that would cause a potential buyer to salivate! It is unsurprising few non-bank or thrift buyers have been seen since 1988.

Second, I believe there are unnecessary impediments, technical or legal in nature, that prevent the RTC from simply getting clear ownership to the assets underlying its problem loans. Could a federal law be developed that secures immediate clear title to such properties, with some sort of failsafe provision for later compensation to borrowers under existing state laws? Similarly, many local building codes and policies should be time-shortened by a federal dispute resolution system to permit the RTC to maximize the value of its assets.

IF THERE ARE NO SAVINGS AND LOANS, WE NEED TO REINVENT THEM

Aside from minimizing the financial effects of the FSLIC cleanup, my other concern is the provision of financial services to the American people. I do not have concern for my former industry as such (just its function), nor for the well-being of their managements or shareholders; rather, I feel it is important to remember that thrifts were federally chartered, commencing in the 1930's, to "promote thrift and help establish home

ownership." If the industry continues its decline, who will pursue what I term the eight-to-one mission of the savings and loan industry? That is, I believe its primary mission is to collect savings from approximately eight families, combine them, and re-lend them to one family for its shelter. Plain vanilla, yes, and that is my recommendation--that we get back to basics. No brokered jumbo accounts, no synthetic mortgages, no junk bonds, no corporate loans, very few commercial mortgage loans--just consumer savings, home mortgages, other family financial services, some judiciously supervised residential real estate development, and the additional power to finance community infrastructure such as sewers, roads, and other improvements incident to home ownership. It is noteworthy that the many existing well-run thriving institutions are basically in this eight-to-one mode. I can think of no institution that gambled on exotic investments that won, yet there are more than a thousand that stayed with basic blocking and tackling that are doing well in a difficult environment.

Yes, I am recommending the reestablishment in this country of a respected specialized financial intermediary, call it a consumer bank, or a retail bank, or a family bank, or a savings bank; an institution concerned primarily with a family's main concern--a home mortgage.

Examination of the financial structure of every Western country, I understand, reveals a specialized financial intermediary confined basically to making residential mortgage loans and other family financial services. If we keep on going at the present pace, we will be the only country in the capitalist world that does not have such an institution, but rather relies for mortgages upon the federal government. Is everyone out of step but us?

THE "OLD" NEW THRIFT

We need to recharter a modernized traditional system, in essence. This "old" new thrift system should be comprised of units that can, if they wish, be large and multi-state, but authority also should exist for diversified types of institutions such as mutuals and/or neighborhood associations. If I were redoing the law, I would question permitting state chartered associations. This dual licensing system where one licensor has no financial responsibility for insuring the firms they make the rules for, hasn't worked well in the past. Most of the problem thrifts, I believe, were state chartered, rather than federal.

The average American family, a Stanford Research study indicates, transacts its financial business with 12 or more types of financial institutions. This clearly is not in the best interests of the family, even if it contains a

Ph.D. in finance, and it is not in the interest of a participating financial institution, which derives only a small fraction of the family's business in exchange for substantial expense and very little income. Permitting families to transact all their business with one or two types of institutions would make them desirable customers for the selected institution, and it would ease the complexity and time drain that today's financial services situation presents to two-wage-earner families.

This Committee has in its power to construct a financial services system to replace one that is shrinking, inaccessible, and unresponsive to working middle class Americans. Greater profitability by undertaking all of a family's business, while prohibiting corporate commercial bank activities, will go a long way toward assuring that the family gets the type of service it needs from its financial services supplier.

In summary, Mr. Chairman, there are many actions you can take that will minimize the dreadful financial effects of this situation. Turf will have to be reapportioned, and risks must be undertaken judiciously with much more private sector input. In addition to ameliorating the cost of dealing with the past, you have the opportunity of fashioning a dynamic financial services industry that will serve Americans far into the next century.

Thank you for asking me here today. Criticism and demonstrations of the need for change can be unwelcome or uncomfortable in this city, so I am all the more appreciative of this opportunity to share my strongly felt thoughts with you. I will be pleased to answer any questions or requests for amplification that you may have.

Financial Services Background of

Anthony M. Frank

Education:

B.A., Dartmouth College, 1953.
M.B.A, Tuck School of Business, Dartmouth College, 1954.

Positions Held:

Glendale Federal Savings, Assistant to the President, 1958-61.
First Charter Financial Corp., Administrative Vice President, 1962-66.
State Mutual Savings, President, 1966-68.
Titan Group, President, 1968-69.
INA Corporation, President of Real Estate and Health Care Subsidiaries, 1970-71.
First Nationwide Bank, Chairman and CEO, 1971-88.

In 1971, First Nationwide Bank (then called Citizens) was a $400 million mutual institution headquartered in San Francisco with 17 branches in Northern California. The institution grew almost 100-fold during the calendar years of Mr. Frank's stewardship, to over $30 billion at the end of 1988, with several hundred branches in 15 states. The institution is now a wholly-owned subsidiary of Ford Motor Company. Second quarter 1990 earnings for the $29 billion First Nationwide Bank (this excludes non-merged problem associations acquired in 1988) were $41 million and non-performing assets at mid-year 1990 were under one percent. The institution has never shown a loss in its 105-year history.

Boards of Directors:

For-profit--Pennsylvania Company; Baldwin-United; National Intergroup; Leisure Technology; and Allianz Insurance.

Non-profit--Blue Shield of California; American Conservatory Theatre; Town Hall of Los Angeles; and Commonwealth Club of San Francisco.
Overseer, Tuck School

Mr. Frank owns no securities in any thrift.

Industry Affiliations:

Chairman, California Savings and Loan League, 1982.
Chairman and Vice Chairman of the California Housing Finance Agency, 1972-81.
First Chairman, Federal Home Loan Mortgage Corporation Advisory Board.
Member, Federal National Mortgage Association Advisory Board.
Member, National Housing Task Force, 1988.
Chairman, Federal Home Loan Bank of San Francisco, 1969-70.
Vice Chairman and Industry Director, Federal Home Loan Bank of San Francisco, more than a decade during the 1970's and 1980's.
Director, Nevada Savings, 1967-69. This was the first bankrupt savings and loan during the 1960's--appointed by the Federal Savings and Loan Insurance Corporation.

Significant Accomplishments:

Co-originator (with Richard Sandor) of the Government National Mortgage Association interest rate futures concept on the Chicago Board of Trade.

Co-originator (with John Carr) of the management consignment concept, whereby large well managed associations would temporarily manage associations seized by the FSLIC.

Presently serves as Postmaster General of the United States, with chief executive responsibilities for the largest employer and the seventh largest corporation in terms of revenue in the United States, since March 1, 1988. Annual cost increases have been reduced from twice the rate of inflation in 1988 to two percent under inflation in 1990.

The CHAIRMAN. Let me just ask you on this last point, you lay out sort of a model and you say that the other industrialized countries in one way or another have such a structure, and that we seem to be losing ours——

Mr. FRANK. Yes.

The CHAIRMAN [continuing]. Or not having an adequate one.

In your mind, do you then see two kinds of financial institutions that would be quasi-banking institutions side by side, sort of the traditional bank that would be the commercial bank, and then the community bank that sort of does the family oriented things, and these two would be separate?

Could they be under the same holding company? I mean, can they be side by side operations with the same owners and shareholders? What would you envision?

Mr. FRANK. I think they could, but I think they would have different capital requirements, and different regulators. It takes an entirely different regulator to worry about loans to Europe or the Far East than it does whether the loan ratio should be 67 percent or 76 percent. So they need to be regulated differently.

And institutions such as consumer banks should not have the opportunity to look at the other side of the street, because there are many times in the cycle when making mortgages is not the most profitable thing to do. The answer is, "that is what you are chartered to do".

That is the way we built suburbia in this country and that is the way we could build housing for moderate income, which I think we need to do, by confining institutions to making mortgages as part of serving families.

Yes, they ought to be totally distinct.

The CHAIRMAN. Now just to test that a bit, you are saying that if you tried to have a single sort of unitary bank that could do both of these things, that these things are so different and so at odds with one another that that is a recipe for disaster in another form? You are saying they have to be separate? They have to be separately regulated, but they could be under the same holding company umbrella as long as there is a legitimate——

Mr. FRANK. The same holding company, but different capitalization and different management, and no choice.

In other words, when you have a choice, there is always going to be one side of the street that is more favorable than another.

America's life insurance companies make no bones about designating a particular calendar year as a mortgage year or a nonmortgage year.

They do that. And that is their business. But we cannot afford to have America's banks designate mortgage years and nonmortgage years depending on how the differentials are in other investments.

The CHAIRMAN. Mr. Glencorse, how do you react to what he has just said?

Mr. GLENCORSE. Well as I ended up my comments, I am concerned about the thrift industry. I think that there is definitely a place in our country for the thrifts.

You have to have the intermediary. You have to have the specialists. That has been the problem with the thrifts of diverting away and getting into things they did not understand.

Talking the other side of the coin, when you get into foreign investment and what have you, there are absolutely different ground rules and everything goes. I agree with Tony 100 percent.

The CHAIRMAN. Mr. Shanahan, what is your view?

Mr. SHANAHAN. Yes. I would agree completely. The one thing that we have to emphasize is that the commercial banks will make loans when the cycle—as Tony pointed out, the same thing that the insurance companies do—at certain cycles when it is advantageous economically.

You therefore have to have some incentive for the thrifts, and present tax incentives obviously are it. We have the different reserve requirements than the commercial banks.

You have to have that, together with the QTL test or some other sort of requirement to be sure that this group—and as Tony points out, again, without this we would be the only developed nation in the world that did not have an emphasis on housing.

And as I closed my statement, that is what the people want. Clearly they want housing.

We have to have the incentive, and I would endorse his proposal completely.

The CHAIRMAN. Senator Sanford, do you want to use the remainder of my time right now, and then we will go to Senator Heinz?

Senator SANFORD. Yes, please.

What do you think about the mutual savings and loan? We started off almost exclusively, as I recall, with mutual savings and loans and did very well.

Then when we permitted stock-owned institutions and converted many mutual institution to stock institutions. It was at about that time that you saw all kinds of mischief beginning to emerge, and then finally this total mischief.

Do you envision going back to a mutual concept?

Mr. FRANK. No, I think it should be a dual system in that sense. My institution, First Nationwide—I did not put it in the résumé—was the first institution to convert from mutual to stock.

We did it in 1972. We added capital. Mr. Glencorse can tell you that his capital, 15 percent, came from converting——

Senator SANFORD. So it is the capital situation that is helped by being a stocked-owned institution.

Mr. FRANK. Yes. You do have some pressure for earnings that you might not in a mutual; that might not be good. You do have the possibility, if you are not doing well, or if you are doing very well, that it be taken over by somebody else; that is a matter that cannot be done with a mutual.

The answer is, we ought to have all types of specialized financial institutions: mutual and stock, large and small, unitary and multiple.

Senator SANFORD. Let me ask you just one other question. I know you are such an extremely busy person, and we appreciate your turning your attention to this.

If we wanted to pursue now some specific legislation, could you provide us a little additional advice and time with maybe some very top staff people?

Mr. FRANK. Of course. I am pleased to be asked. Of course.

Senator SANFORD. Thank you, Mr. Chairman.

Mr. SHANAHAN. Senator Riegle——

The CHAIRMAN. Yes.

Mr. SHANAHAN [continuing]. As a mutual, perhaps I could answer Senator Sanford's question, because you would think I would have a bias, and I would have to tell you that is not the major factor, whether stock or mutual.

There were crooks and stupid people in——

Senator SANFORD. Oh, yes. I did not mean to imply otherwise, except that the creation of stock-owned institution did open up the door a bit.

The CHAIRMAN. Senator Heinz.

Senator HEINZ. Mr. Chairman, thank you.

Well, first I am delighted that the Postmaster General is here. I trust the mail is still in good hands.

Mr. FRANK. We are having trouble with the two Senators Kerry/Kerrey, but other than that [Laughter.]

Senator HEINZ. Yes. Well we have had all kinds of trouble with them, too. [Laughter.]

I would not want anything I say, Mr. Chairman, to interrupt Postal Service in Pennsylvania, but I do note, Tony, that in your prepared statement you advocate a plain vanilla approach for S&L's.

Mr. FRANK. That is true.

Senator HEINZ. In other words, thrifts, in your view, should that concentrate on collecting savings from families and re-lending them in the form of home mortgage loans.

Now as I am sure you recollect, back in June 1982 the State of California adopted one of the most liberal thrift laws in the country.

It was not like the Federal legislation that was passed later in the year Garn-St Germain.

The California law authorized State-chartered institutions to engage in almost any activity, invest up to 100 percent of assets in direct investments, including equity investments in real estate projects, and my understanding is that the California Savings & Loan League was a prime sponsor of this legislation.

It is also my understanding that in 1982 you were chairman of that organization.

Is that right?

Mr. FRANK. I do not think so.

Senator HEINZ. You were not chairman of the California League?

Mr. FRANK. I was chairman of the California League. I am not sure what year. I would have to look it up.

Senator HEINZ. Well, let me ask this. You were involved in the League in 1982, I assume.

Mr. FRANK. Yes.

Senator HEINZ. The question I have got is, can you recollect what kind of economic conditions there were in California that led that organization to sponsor such broad deregulation?

Mr. FRANK. What you had is several institutions, led by my own, which converted from State-charter to Federal because we were going interstate, and hence our name, First Nationwide.

We did go interstate in 1981 or 1982. The State of California saw a need to spruce up their charter to keep California-chartered insti-

tutions, so they went to the ultimate, which is, as you say: You can do anything.

I was very much against that. I fought against it. I fought against it at the Federal Home Loan Bank level. I supported efforts by Ed Gray to minimize that to 10 percent, even though Federal associations had 3 percent.

I think it was very ill-advised and, as I said in my testimony, it was particularly ill-advised because the people making the rules do not have any financial involvement.

There is no State insurance fund in California. Any mistakes that are made fall on the FSLIC, and indeed that is what happened.

I think—I might not be accurate—but I think there is only one Federal association in California that failed. All the rest were State-chartered. It was a dumb idea.

Senator HEINZ. What was your principal argument against the California Savings & Loan League doing that?

Mr. FRANK. That it made it possible for institutions to take in money under the auspices of the Federal Government at the Federal Government rate and not make any mortgages—not make any mortgages.

Senator HEINZ. Back then were the plain vanilla S&L's successful under those conditions or were they the ones that were most under the water due to interest rate mismatch?

Mr. FRANK. The ones that were well-capitalized managed to pull through the 1979 through 1982 crunch. Of course one of the first actions of the Reagan administration was to permit variable rate mortgages, and that was helpful. That was in 1981, I believe.

Senator HEINZ. The reason I ask is that, to the extent that S&L's got into trouble initially in the 1970's and early 1980's, due to having been involved in strictly home mortgage lending before there were variable rate mortgages, my recollection is nationally that they were the ones that were most hurt by the interest rate mismatch.

The question I really have for you, the policy question, is: If we were to be very stringent on S&L's and require them to do the plain vanilla operations as we have been discussing, is it possible that history could repeat itself and that they once again could develop the kinds of mismatches and losses that weakened the capital structure of the S&L industry as a whole?

The other side of that coin is, is it possible that institutions that have a more diversified portfolio—I am not talking about high-flying, but a more diversified portfolio might be more successful?

Mr. FRANK. Well, that is a very perceptive question. Clearly an institution that takes in short-term money and makes long-term fixed-rate loans is always exposed to failure. There are some ways to fix that.

There could be a deferred tax program that could reimburse the institution somehow when yields went adversely. We could develop better hedging and guarantee systems. But within the entire mortgage portfolio it is possible to diversify.

You can have some adjustable rate mortgages and some fixed that relate to 8 and 10 year savings accounts, which is a pretty good match. You can have a variety even within a mortgage portfo-

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lio. But a mortgage portfolio comprised exclusively of long-term fixed-rate mortgages, yes, could expose the industry to a disaster again.

Mr. SHANAHAN. Senator, could I follow up on that——

Senator HEINZ. Yes, Mr. Shanahan.

The CHAIRMAN. Certainly.

Mr. SHANAHAN [continuing]. Because I lived with that very closely. Yes, we lost money. We did not do it because we were stupid. We were not allowed to—the law did not allow us until 1981 to make adjustable rate, variable rate mortgages. We lost money, but we decided to stay in the business we know. The answer is: Do you need all these other benefits? I question it.

You have brought two institutions here who have stayed with the basic principle, have not gone out and taken those changes, and I think we are evidence that you can do very, very well if you keep your operating costs down, do not have illusions of grandeur with big buildings and all the other grandiose schemes, you can do well and we are proof.

The CHAIRMAN. Thank you, Senator Heinz.

Senator Kerrey, did you—no, I beg your pardon. Senator Sanford, you just had a minute of my time. You are next here, and then we will go to Senator Kerrey.

Senator SANFORD. No, I think I am all right. Time is running out for these gentlemen, too.

The CHAIRMAN. We have to take up the FIRREA legislation—the FIRREA CAFE—we use all these acronyms—at 11:30.

Senator SANFORD. I would yield to Senator Kerrey.

The CHAIRMAN. Senator Kerrey. Would you pull that mike around. We are delighted, again, to have you here.

Senator KERREY [Nebraska]. Thank you, Mr. Chairman.

I would direct the question to all three of you. Tony has referenced it more specifically. That is, this need to organize this thing with a strong, independent board. I guess I am particularly struck by one of the qualifications that you put in there, which is someone who does not campaign for the job.

If you could elaborate a bit more, one of the things again that worries me a great deal is that the American people, and particularly the working middle class, one of the things you say at the tail-end of your testimony is that there is decreasing opportunity to be served by financial institutions among our working middle class particularly as it relates to the need to get a mortgage on a home, and they in the main are the ones who are apt to be asked to pick up the tab for this, and I guess I am increasingly concerned that they are not going to give us permission to do it.

They may give us permission to do some of the other things that have been suggested to go after the people who have abused the system that may be put in jail, and maybe some alterations in the law to enable RTC to work better, but when it comes to the mainline appropriation to get $122 billion out of working class Americans to put into a system that may no longer even serve them, I think is going to become exceedingly difficult to do.

It feeds then the fears that you have raised in me that this is not just a problem, that it should be seen as a major national dilemma that needs to be addressed. If you could put some more detail on

your sense of what an independent board like this could do in terms of establishing a more trusting relationship between the public itself?

Mr. FRANK. Well clearly it is not working to have it peopled exclusively by the Federal Government. Clearly this committee and the comparable House committee would not agree to turn it over exclusively to the private sector without oversight, but I think the public would have a lot of confidence if we put some of our great business icons on this board who were willing to work on it. I will mention some names. I mean——

The CHAIRMAN. Don Petersen?

Mr. FRANK. Don Petersen, Lee Iacocca who is apparently going to retire within the year——

The CHAIRMAN. Warren Buffet.

Mr. FRANK [continuing]. And Warren Buffet, and maybe Mike Blumenthal, and maybe Bill Simon, and maybe Victor Palmieri. Those are names that quickly come to mind.

Those are great people that have track records of honesty and performance, and are willing to take a chance, and are willing to promote risk at the expense of reward. I think that would give the American people a great deal of confidence.

The CHAIRMAN. And lead the country out of a crisis situation.

Mr. FRANK. Yes, sir.

The CHAIRMAN. I mean, I think that is part, if I may just interject, it seems to me what you are saying, you see this as a size and jeopardy to the country that if we do not get on top of this thing and get it in a streamlined set of competent hands, we could end up in a tumble of events that could really damage this country far more severely. Is that not what you are saying?

Mr. FRANK. Absolutely. What we have not mentioned is the effect of dumping all this real estate, even if you were to get ahold of it, which is difficult, and the effect it would have on the healthy institutions.

You can be a 67-percent lender, but if price levels go down 33 percent, through no fault of your own suddenly you have got a 100-percent loan. That could be the case for a lot of institutions here if we are not careful with how we put this real estate out there, and we are not being careful.

The CHAIRMAN. Excuse me.

Senator KERREY [Nebraska]. Just to follow up, again, I would actually add a fifth thing to your list of things that you suggest. I think you are correct that the numbers are quite large, and it is very difficult for all of us to get a sense of what it means, of what these numbers mean, but I think there will be a meaning given to increased taxes to pay for, to reduce social programs that can be social programs like farm programs, to the loss of international power, to higher interest rates that are probably there now. I mean, the group of seven may recommend that six out of seven raise interest rates, but I suspect that it is going to be awfully difficult for the Federal Reserve to do much, no matter what comes out of the budget summit.

Plus, as I said, the fifth one is perhaps the most tragic of all, and that is decreasing access to the very institutions that the middle class is going to be paying for in this case.

I guess, Tony, I am asking again, as somebody who is a bit removed from this political field here, project yourself now 30, 50, 60 days away from this moment after we have cut the budget and increased taxes, which I predict will occur now with the President and with both Republican and Democratic leadership in support of doing that, the likelihood that under that scenario that the Federal Reserve is not going to be able to moderate much on interest rates with $120 billion of new energy costs being pulled out of the economy, with $38 a barrel in oil, I mean it seems to me that this emergency that you are describing 30 or 40 days from now is only going to be worse.

Mr. FRANK. Well, as I tried to carefully say in my testimony, in conjunction with other events—and that is the point of your statement just now—in conjunction with other events. We have seen these figures escalate and escalate, and now people say, gee, they have escalated to the point they are now, but why would they not keep escalating?

Why do people possibly conceive that these figures have reached the point of reality? They have not. If we continue on this course, it is going to get worse. So I think we need to take action that would meet the test of, hey, this is a national emergency. Is this action comparable with a national emergency?

Yes, I am worried about it. I am worried about the effect on social programs, taxes, interest rates, competition. There are going to be a lot of one-bank or one-thrift towns in the United States, and many more coming up. That is not good for people.

There is a lot of absentee ownership. That is not good for people. I think we are heading the wrong way, obviously.

Senator KERREY [Nebraska]. I guess I would put it to Mr. Glencorse and Mr. Shanahan, as well. I assume you have a fairly good sense of what your depositors and borrowers' attitude is toward this whole problem.

Assuming, again, that they are sitting there 50 days from now with higher taxes, higher interest rates, and decreased social programs, as well as perhaps a decreased access to credit, what is their attitude going to be when they are told that we need another $120 billion to put into this program?

Mr. SHANAHAN. Senator, if I could, I agree with you that the feeling, the reaction of the electorate is very strong. I would urge, however, and the point of my testimony would say that we have to differentiate between the scoundrels who are the minority and the majority of institutions who did nothing wrong, who came as I did 5 years ago and said you are doing it wrong, and we did not get much attention.

Senator KERREY [Nebraska]. Well, Mr. Shanahan, in this case I am saying I will guarantee you that if I raised it—and let me just put it in personal terms—if I vote to raise taxes, decrease social programs including agriculture which is very important to my State, perhaps increase interest rates still as a consequence, and decrease access to credit, if I do all four of those things, and then I go to them and I say: I want $122 billion for this program for next year? It is I who am going to be accused of being a scoundrel.

As I suggested at the beginning, I do nothing unless I get permission from the people to do it. I do so at my own risk. So what I am

concerned about is that the jaws of consent are going to snap shut at the very moment that we need bold action.

I am very fearful that that will occur.

Mr. SHANAHAN. I do not propose to know how to solve the RTC problem. I do know, as Stony has said, that they cannot be second-guessed as rapidly as they are at the present time. That is an enormous problem.

I am urging, however, that we not put everybody in the same barrel, because most of the institutions do not belong there and never got involved. And as Senator Sanford has just said, in every State there are a number of institutions that do not belong. I do not know the answer to that RTC. Tony's proposal sounds like a very good one, but this is going to be a Herculean task; there is no question about it, Senator.

Senator KERREY [Nebraska]. Thank you.

Senator SANFORD [presiding]. Thank you very much. I think we are about ready to bring this hearing to an end.

I am worried about the fact that we are going out in 2 or 3 weeks. That is going to leave us as we were in 1988 with the regulators doing whatever they chose to do. I wonder if there is something that we ought to do before we adjourn.

Your idea about the super-governing advisory board, or whatever we would call it, cannot wait until February or March, can it?

Mr. FRANK. It can wait, sir.

Senator SANFORD. It will cost us money to wait until February or March——

Mr. FRANK. It can wait, but it will cost money.

Senator SANFORD. But it might be worse than costing us money. It might get the RTC into a tangled situation that we cannot get out of.

You might be thinking about what we could do in the interim. I do not know whether we could do something to express the sense of the Congress. It would be very difficult to get any legislation through between now and the end of this session, especially legislation that has not yet been drawn.

Mr. FRANK. This enormous emphasis on curing the problem before 1992 I believe is going to be very costly. Some of these problems can be cured other than by sale. As I said in my testimony, I have reams of personal experience where things held off the market appreciated and they did not cost money immediately, did not impact the budget immediately, and right now there is a thirst and a drive and an urgency to solve everything right now—get it out there, sell it, close it, and that is costing a lot of money that I am not sure it is necessary to incur.

Senator SANFORD. We went through an experience some years ago when the REITS got overextended and high interest killed them off, and killed off the developers; in turn the REITS were killed and in turn, the banks that were the sponsoring parents were put under stress.

Mr. FRANK. Right.

Senator SANFORD. And we learned, it would seem to me, a lot of lessons. You have even alluded to a couple of them indirectly, of how we took that property and did not just throw it on the market but worked it out. In that situation, you had the parent organiza-

tion, generally a bank, that was a parent in a disconnected kind of a way, but that gave it some stability which I suppose was the difference between the REITS crisis and the S&L crisis.

Mr. FRANK. I think that is a very good analogy, the REIT analogy. There are some things that should be sold right away such as single-family housing that is not occupied and so on, but items that need tenancy, the buyer is going to apply the same calculations as you do, and he is not going to pay you more than present value, so you might as well keep it.

Senator SANFORD. It would seem to me that we could afford to keep some of this type of property, since it is not generating enough to make much difference, at least so far.

Mr. FRANK. I would think so, too, that you can afford to keep it, but that is not the thrust that is happening right now.

Senator SANFORD. I regret not having come to the first part of this hearing, but I had a meeting with President de Klerk from South Africa. I was able to leave when he went to speak to all of the Senators who came to lunch, because I was very anxious to come here.

It seems to me that this is almost the first time that we have taken a positive look at this. This committee has been very properly looking at the emergencies and how do we address them, but we have not looked at how we save the positive and profitable S&L concept which are so important I think to the Nation, whether you name them something else or not. A different name might be a good psychological move.

I just hope we can have you all available to at least some of our senior staff people that we can begin to try to do something for the first of the new session.

But I also would hope you would think about, and maybe we can talk again informally, about what we might do before the end of this session in order to help hold things together that I am afraid are flying to pieces.

So if you would care to continue some kind of a dialog, I would be most happy, and I am sure other members of this committee would be, to do so, and especially since we have got you where we can reach you handily. So we would like to call on you, and I know you would be in touch with other members of the sound part of the industry, too.

Mr. FRANK. Yes, sir.

Senator SANFORD. It just seems to me that I worry about our leaving town and leaving this without at least a little bit more tidying up.

Mr. SHANAHAN. Senator, our livelihoods are in this completely, and we are at your disposal. We are delighted that you have invited us, and we will be here any time you want us.

Senator SANFORD. I think it would be more efficient if we put together a little task force under the supervision of the Senators, but with some senior staff people who can devote more attention to it.

Mr. FRANK. Well, I would be very glad to work with Mr. Harris and staff, sure.

Senator SANFORD. Do you have any other comments that you would like to add to the record?

Mr. FRANK. I very much appreciate the attendance and the attention here today. I think we are really heartened that this committee is looking forward. There is plenty to look backward at, so I am glad it is also looking forward.

Thank you, very much.

Senator SANFORD. Thank you.

We will stand adjourned.

[Whereupon, at 11:36 a.m., the committee was adjourned, subject to the call of the Chair.]

THE CONDITION OF THE THRIFT INDUSTRY

THURSDAY, SEPTEMBER 27, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:32 a.m., in room SD-538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

Present: Senators Riegle, Dixon, Shelby, Kerry, Graham, Sanford, Bryan, Garn, Heinz, Gramm, Bond, Mack, and D'Amato.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

I'd like to just indicate at the outset that Senator Dixon and I were both over testifying before a committee on the House side this morning. They were interrupted at a vote, just at the critical moment, and that delayed us. So we were delayed getting here. So by way of explanation, that's the reason we're getting a bit of a late start.

Before we begin the hearing this morning, I want to announce for the record that, as members arrive, they'll be recording their votes on favorably reporting the nomination of Richard Roberts to be a Commissioner of the Securities and Exchange Commission. And we'll begin the period for voting now and it will extend until this hearing concludes. If a quorum is established in that time, the final vote will be announced as we adjourn and the nomination will be reported to the full Senate later today.

And I want to indicate that I'd like to be recorded in the affirmative.

Does any other member want to——

Senator SHELBY. [Nods in the affirmative.]

Senator GARN. [Nods in the affirmative.]

The CHAIRMAN. Senator Shelby recorded in the affirmative, and Senator Garn.

Senator DIXON. And I just want to say I'm delighted to support this very fine nominee, who obviously has acquired the skill and knowledge he has from his service with my distinguished friend from Alabama.

I vote aye.

The CHAIRMAN. Very good. And so, we'll proceed in that fashion with respect to that nomination.

Now today is a very important hearing as well in terms of our having the good fortune to have Director Tim Ryan of the Office of Thrift Supervision with us to give us his views on the condition of

the thrift industry, as he knows better than anybody else, and we certainly appreciate.

This is one of the toughest jobs in government that he has. And he's been at it now for some period of time and has had the opportunity to, I think, not only grapple with these problems, but to develop a sense for where this industry is and where it may be going.

Certainly, the savings and loan problem was a long time in the making. For too long, the public, and I think the Congress and the press and everyone, for that matter, did not fully comprehend the seriousness of the problem.

I thought the other day that when Chairman Breeden from the SEC was here and he was reviewing the long history over roughly the 15-year period of time that, because of a series of events, we kept doubling the bets, we kept doing things with forbearance and counting gimmicks, if you will, that presented a picture that was at odds with the true facts, but each time with the idea in mind over a long stretch of years that more time would allow the problem to self-correct.

And as the bets kept getting doubled and doubled again, the work-out strategy did not succeed and left us with a far bigger problem in the end, complicated very much by the State powers problem which was, I think, too much off the radar screen in terms of the dimensions of the liabilities that were in that area.

In any event, on September 25, we heard from three witnesses with experience in managing healthy savings and loans. The message that they gave us was simple—for safety and soundness and continued profitability, it's best in their view to stick with the basics; and that is, to concentrate on what savings and loans were set up to do, and that is community activity centered around home lending.

The data that Director Ryan recently has released confirms this message that success in the savings and loan industry is almost always found at the plain vanilla savings and loans who make prudent home mortgage loans, keep their operating costs low, and tend to stay in markets that they know well.

The OTS has divided thrifts into four different groups.

The healthiest thrifts, the group 1 thrifts, have an average tangible capital ratio of 6.4 percent, have the highest return on assets and the highest percentage of assets in home mortgage loans.

Group 1 thrifts have an average of 56 percent of their assets invested in single family mortgage loans.

On the other hand, the sickest thrifts in group 4 destined to go to the RTC, have only 32 percent of their assets in home mortgage loans.

The other primary lesson we learned from the savings and loan problem is that State regulators should not be allowed to grant wide powers to financial institutions that have Federal deposit insurance.

In FIRREA, we shut down the excessive powers of savings and loans with State charters by prohibiting junk bonds, limiting direct investments, and giving the FDIC authority to review any additional powers granted to State-chartered savings and loans.

I am concerned that some State legislatures have already recently enacted laws to allow existing savings and loans to change char-

ters and receive new powers. That concerns me, and Director Ryan indicates that it is a concern to him as well.

And so I would very much like for us to be able to hear his recommendation, or know his recommendation, on that subject.

I'm also very interested in what Director Ryan has to say about the policy of letting some thrifts pay dividends when those thrifts do not meet the capital standards that will be effective by the end of the year. We have that problem as well over on the banking side, and that is also now an issue that is coming into focus.

So I very much want to welcome Director Ryan. Let me yield to Senator Garn.

[The complete prepared statement of Chairman Riegle follows:]

PREPARED STATMENT OF SENATOR RIEGLE

Today, Director Tim Ryan from the Office of Thrift Supervision will present his views on the condition of the thrift industry. The savings and loan problem has been a long time in the making, and for too long the public, the press and Congress did not understand the seriousness of the problem.

On September 25, we heard from three witnesses with experience in managing healthy savings and loans. The message they gave was simple—for safety and soundness, and continued profitability it is best to stick with the basics.

The data that Director Ryan has recently released confirms this message that success in the savings and loan industry is almost always found at the plain vanilla savings and loans who make prudent home mortgage loans, keep their operating costs low, and stay in the markets that they know. The OTS has divided thrifts into four different groups. The healthiest thrifts—the group 1 thrifts—have an average tangible capital ratio of 6.4%, have the highest return on assets and the highest percentage of assets in home mortgage loans. Group 1 thrifts have an average of 56% of their assets invested in single family mortgage loans. The sickest thrifts in group 4, destined to go to RTC, have only 32% of their assets in home mortgage loans.

The other primary lesson we learned from the savings and loan problem is that State regulators should not be allowed to grant wide powers to financial institutions that have Federal deposit insurance. In FIRREA, we shut down the excessive powers of savings and loans by prohibiting junk bonds, limiting direct investments, and giving the FDIC authority to review any additional powers granted to State-chartered savings and loans. I am concerned that some state legislatures have recently enacted laws to allow existing savings and loans to change charters and received new powers. This concerns me, and Director Ryan indicates it concerns him. I would like to know his recommendation.

I am also interested in what Director Ryan has to say about the policy of letting some thrifts pay dividends when those thrifts do not meet the capital standards that will be effective by the end of this year.

I welcome Director Ryan to the committee and look forward to his views.

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Thank you, Mr. Chairman.

Mr. Ryan, welcome to the committee again. Let me say at the outset that I think that you've done a very credible job over the last few months under an extremely difficult situation. You inherited an agency with incredibly large problems and I appreciate the way you have attacked those problems and most importantly, your candor. You've been very straightforward with the committee and I notice in your press statements as well, that you haven't tried to varnish anything. Just—this is the way it is—and I think that's very helpful to helping solve this problem.

Today's hearing on the thrift industry is certainly an important one. I don't think anyone needs to be reminded of the consequences to the taxpayers of the continued thrift failures.

But at the same time, and as your charts will show, I need to note that the second quarter results reported by OTS this week indicate that a large segment of the industry is indeed healthy and profitable.

I think we tend in the headlines and the hearings to forget that there are still a lot of fine S&L's out there that are well capitalized, well managed, conservatively run, and they're doing a good job for the purpose for which they were intended.

I think it's unfortunate that because of guilt-by-association these healthy S&L's are not understood and people don't realize that there are a majority which are doing a very good job and are well run.

While we need to be as clear as possible on what we think the remaining and anticipated failures will cost the taxpayers, I want to be just as clear about our need to focus on the institutions that can survive.

We benefit no one, and certainly no taxpayer, if the agency and the Congress are so intent on minimizing the damage from the thrifts that have already failed, that we take actions that unintentionally or inadvertently force others into insolvency, or discourage the flow of additional capital into the industry.

Mr. Chairman, I commend you for the timing and focus of this hearing. We need to take an unflinching look at the condition of the thrift industry. But we also need to hear what the OTS has done over the past year to implement FIRREA and otherwise respond to the volatile and fragile condition of the industry.

Also, Mr. Ryan, if you believe that any legislative changes are needed, and I happen to be one who thinks we do need to make some legislative changes, we want to hear that message from you, if not today, as quickly as possible, so that we can address any changes that need to be made very early in the next session, we get into what both the chairman and I hope is a very broadly based deposit insurance reform, as well as structural reform bill.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Garn.

Senator Dixon?

Senator DIXON. Mr. Chairman, I'm delighted to have Mr. Ryan here and I'm going to put my statement in the record because I'm anxious to hear from our good friend, Mr. Ryan.

The CHAIRMAN. Very good.

[The opening statement of Senator Dixon follows:]

OPENING STATEMENT OF SENATOR DIXON

Senator DIXON. Mr. Chairman, I am pleased to be here this morning as the Senate Banking Committee holds its second hearing this week on the condition of the thrift industry.

On Tuesday we heard some frank testimony from Tony Frank, currently our Postmaster General and formerly the CEO of a respected thrift in California. He testified that we must consider the situation in the savings and loan industry as a national emergency and act accordingly. He further stated that FIRREA was a sound reaction to the 1989 situation but that it no longer is today. He

called for appointment of a thrift czar and of a blue ribbon board of private sector experts to replace the present RTC Oversight Board.

Today, we hear from Tim Ryan, Director of the Office of Thrift Supervision. I look forward to his testimony and to his reaction to the ideas presented at this past Tuesday's hearing. Does Director Ryan see a future for the thrift industry? What changes to FIRREA does he believe are needed? And, above all, what can be done to save taxpayers' money in resolving failed thrifts?

The CHAIRMAN. Senator Heinz?

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. I join you in welcoming Mr. Ryan. I commend you on holding this hearing.

The obvious concern that we all have is that the thrifts that are so-called healthy thrifts, the ones supervised by the Office of Thrift Supervision, lost $196 million in the second quarter of 1990.

That sounds bad, but I guess it's good compared to what those that the Resolution Trust Corportion has. They lost some $2.6 billion in the same period.

But I think we all have to be concerned about the direction in which those numbers are headed, the direction in which the economy is headed, and whether, given the weakening of markets now outside of the southwest, particularly in New England and the Middle Atlantic area generally, as well as New England, we are not about to see what, according to the second quarter numbers was particularly for the group 4 thrifts and some of the group 3, not an ideal performance, whether we're headed to a larger group of thrifts ending up either in group 4 or worse, going from group 4 to the RTC, and the costs attendant thereto.

I think Tim Ryan's got a very big job on his hands to prevent that from happening. That's his goal. That's his mission. And like Senator Garn, I want to inquire of him what steps are needed, in his judgment, to make sure that he has the tools to meet that goal.

The CHAIRMAN. Very good. Thank you, Senator Heinz.

Senator SHELBY?

OPENING STATEMENT OF SENATOR SHELBY

Senator SHELBY. Thank you, Mr. Chairman.

I want to join the other people, Mr. Chairman, that commend you for calling this hearing. I think it's timely. Some of the problems seem to be not just going away, Mr. Ryan. The earnings of the healthier two-thirds of the savings and loan industry continue to be dwarfed by the losses of the bottom, the insolvent one-third, approximately there.

Moreover, the losses in the bottom third of the industry, according to data that I've been getting, are worse than a year ago in most places. That's certainly a discouraging trend. I'd like to have some other news. Maybe you've got some.

I believe part of this committee's task is to determine from testimony and other evidence whether FIRREA is working. Is it responsible? Is it doing the right thing? Is it doing what we want it to do? Do we need these changes?

It just seems so troubling out there that we don't have a concrete idea of how much this is going to cost the American people.

You deal with it every day. We grapple with it. The administration and various analysts throw out numbers. The GAO has different numbers from everybody else. Maybe they're right. Who knows?

But the fact remains, this is a monumental problem and we've got to put some numbers on it. You know, a year ago, as you'll recall, $50 billion was going to do the job. Well, $50 billion won't get it started, probably, from the inside tasks that you have.

So I look forward to your testimony. I would like to hear what you've got to say and hope that you can find some solutions to a terrible problem.

Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Let me just say, as you get ready to start here, Director Ryan, that I know how hard you've been working. This is a tough, thankless job, as you knew when you came into it.

I know you've been putting in long hours essentially 7 days a week. I know the burden that is personally and for your family. We appreciate the effort that you and your staff are making. It's not gone unnoticed by this committee.

Mr. RYAN. Thank you.

The CHAIRMAN. So we'd be pleased to hear from you now.

Before we begin I have statements of Senators Sanford and D'Amato.

OPENING STATEMENT OF SENATOR SANFORD

Senator SANFORD. Thank you, Mr. Chairman, and I would like to also think Tim Ryan for being with us and for his thorough testimony.

Today's hearing, in conjunction with the hearing held on Tuesday, as well as previous hearings this month, should give us a fairly comprehensive picture of the state of the thrift industry and the scope of the problems still facing us in trying to stop the losses from the thrift industry, close down the insolvent thrifts, sell the assets from those thrifts, prosecute and jail those who are criminally responsible for many of these losses, and put in place a supervisory structure and examination process that ensures that never again we will face this type of crisis.

This morning we must again face some grim realities. The thrift industry is very much affected by the state of the economy, particularly the real estate market. With downturns in that market, particularly in New England, but increasingly in other parts of the country, the ability of some of our thrifts to climb out of the hole they are in is diminished. Any deterioration in real estate lending or increase in interest rates is only going to make the problems facing thrifts worse and the cost to resolve the problem higher.

We also need to examine whether the changes mandated by FIRREA have been properly implemented and whether those changes are setting us on the right course to get out of this crisis. We should also look at just what the future of thrift industry is

likely to be and whether the charter now available for thrifts is an attractive enough charter to permit viable, profitable institutions.

Again, I thank Mr. Ryan for his work to date and look forward to hearing his testimony.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Mr. Chairman, thank you for convening this hearing today to examine the condition of the thrift industry. I am pleased to welcome today's witness, the honorable T. Timothy Ryan, Jr., director of the office of thrift supervision.

Under FIRREA, the office of thrift supervision has a great responsibility as the primary Federal regulator of the Nation's thrifts. I look forward to hearing this morning a frank appraisal of the S&L industry's current economic position from the OTS perspective, and so I shall be brief in my opening remarks.

In particular, I will be interested to hear what regulatory measures OTS has established to comply with FIRREA, for example, those governing capital standards and dividend policy. Mr. Ryan's view of what—if any—additional legislative action is required will be of assistance to this committee as we continue to address the critical issues facing America's financial institutions. Finally, a candid forecast of the industry's future would be most helpful.

The thrift industry's poorest performers have cost this Nation billions of dollars and much of its traditional confidence in American financial enterprise. Just as we pursue those whose negligence and recklessness have caused the damage we now seek to repair, so promoting an effective and vigilant Office of Thrift Supervision will continue to be among the highest priorities not only for this Senator and this committee, but for the American taxpayers most of all.

Thank you, Mr. Chairman.

STATEMENT OF T. TIMOTHY RYAN, JR., DIRECTOR, OFFICE OF THRIFT SUPERVISION, WASHINGTON, DC

Mr. RYAN. Thank you very much for the opening comments.

It's a pleasure to be here before the committee to testify on the current condition of the private sector thrift industry.

I've been asked by the committee to discuss four topics this morning.

First, the current economic condition of the thrift industry.

Second, the regulatory measures that have been adopted by the OTS to implement FIRREA.

Third, my views and recommendations on possible structural changes in government regulation of depository institutions, including deposit insurance.

And fourth, the future role of the thrift industry.

I will address each of these topics in turn.

First, the economic condition of the industry. As all of you know, the economic condition of the thrift industry is heavily influenced by the prevailing negative economic trends. It is a difficult environment for savings associations to remain profitable and well capitalized.

During the second quarter of 1990, the private sector thrift industry consisting of 2,452 S&L's reported a loss of $196 million.

To understand the thrift industry, however, one must look behind the aggregate statistics. There is not one thrift industry, but several in operation today. OTS segments institutions into four groups according to their financial prospects, and since my arrival at the agency, we have released this data to the public quarterly.

Institutions in group I, and this is displayed on the summary chart over here as to classifications, group I thrifts meet or exceed the minimum capital requirements and have been consistently profitable.

Group II institutions meet or are expected to meet existing capital requirements.

Group III institutions are troubled, with poor earnings and insufficient capital.

While group IV consists of institutions that will likely require government assistance as part of their resolution.

Before reviewing the most recent classifications, I'd like to make a few general comments as to the state of the industry.

First, the deteriorating condition in the real estate markets are having a negative effect on the capitalization and profitability of the thrifts in those markets.

As an example, group I, the healthiest thrifts, experienced a net decline of 89 S&L's between May and August.

Two, new higher capital requirements agreed upon by all financial regulators may result in a downward shift in the thrift groups. Most financial institutions will be required to have higher leverage ratios of at least 4 percent going forward, with regulators retaining the flexibility to establish even higher ratios where appropriate.

Mr. Chairman, OTS has completed some preliminary analysis on the effect of the 4 percent core capital requirement on the groupings of thrifts. This analysis reveals that the imposition of a 4-percent requirement on all but the strongest thrifts would throw approximately 100 S&L's with $108 billion in assets out of compliance with the minimum capital requirements.

I'd like now to review each of these groups very briefly.

First, group I, and this is displayed on the pie charts that John has now put up.

John, if you could stick up that other pie chart, too, I'd appreciate it, just so that they can see that one.

The chart he's putting up right now depicts the number and the chart to the left, the same display, but it's by assets.

Group I, which is the largest—that's in the color green—at the end of the second quarter, was the healthiest, comprised 1,169 thrift institutions. That's 48 percent of the industry, holding $371 billion in assets—that's 35 percent of the total assets in the private sector thrifts.

This group, as the chairman noted in his opening, earned $646 million in the second quarter of 1990 and has been consistently profitable over the last four quarters with net income totaling $2.33 billion.

If you take this group that now consists in group I, the 1,169, and you look back at that group over the last 6 or 7 quarters, you'll see a consistent trend of profitability, which, from my standpoint, I rarely have something positive to talk about. This is one thing that's positive.

Group II. Group II is depicted in the blue. Group II is 674 thrift institutions. That's 27 percent of the industry. Assets of $352 billion. That's 33 percent of the assets in the industry.

This group earned $31 million in the second quarter of 1990 and earned $494 million in net income for the previous four quarters.

Group III, which is in the orange, this group has low earnings and poor capital. There are 350 institutions in this group. That's 14 percent of the private sector. They hold $165 billion in assets. That's 16 percent of the total assets.

These institutions had losses of $153 million in the second quarter of 1990, and they lost close to $800 million over the trailing 4 quarters.

Let's go now to the last group, which is group IV, the yellow.

These institutions may require government assistance. As of June 30, there were 244 institutions. That's 10 percent of the industry, holding $162 billion in assets. That's 15 percent of the total industry in group IV.

Mr. Chairman, we have found, and I have found over the last 6 months, that our group IV classifications are reasonably reliable bases for tracking potential transfers to the RTC.

From April 1 to September 14 of this year, 84 out of the 85 S&L's transferred to the RTC were from group IV. Only 211 S&L's remain in group IV that we classified as candidates for the Government resolution.

Mr. Chairman, I'd like to—and I'll be ready for questions on any of this—I'd like to somewhat quickly hit some of the other three topics you asked me to address.

As you can see, my written testimony——

The CHAIRMAN. Could I ask you just one question that relates to something you said earlier?

Mr. RYAN. Sure.

The CHAIRMAN. At one point, you were talking about the movement from an S&L from a stronger quality category to a lesser quality category. And you've had some movement from people out of group I into group II, and group II into group III.

What are we seeing with respect to a slide of S&L's into group IV? You're having some that leave because they go into the RTC. So you have some that are disappearing out of group IV because they're being, in effect, closed down. And you have some more, presumably, that are coming into group IV.

Can you just give us a sense for whether category 4 is rising, falling, staying about the same, or what the dynamics are of seriously wounded S&L's in and those that are being closed going out the other side?

Mr. RYAN. I'll be glad to. On August 30, we released information which we've been doing about every 2 months now, which takes the economic data, the quarterly economic data, and we look at trends. And I'll be glad to provide this to the committee. I think we already have, but I'll provide it again.

Net changes in classifications, we lost 89 institutions out of group I. We gained 60 in group II. They were mostly from group I moving down to group II, although some from 3's and 4's moved up to 2.

We had a gain in group III of 41, and we lost 64 out of group IV, principally as a result of transfers to the RTC, although one of the

stranger aspects here of this is that we actually had some institutions move from group IV, where, quite frankly, we thought almost all of those institutions would end up in the RTC. We had approximately—I think there's 18 institutions move out of group IV and into groups III and II, principally as a result of recapitalizations.

Senator HEINZ. How many moved down into group IV in that period?

Mr. RYAN. During that period, we had, I believe, 41 move into that group.

We're also at the same time now, Senator Heinz, I think you've seen some of our statistics. On average, we've been moving about five institutions a week over the last year to the RTC. Very close to that number.

So we're moving institutions very quickly.

We're now getting to a point where identifying institutions that are appropriate candidates for the RTC are becoming, as I said at a press conference, a little bit more difficult.

To date, identifying institutions for resolution was generally easy. They're getting more difficult now. The last time I appeared in this room, Mr. Chairman, with Chairman Seidman, he talked about his supervisory management program, which we have yet to agree on. And it's geared toward identifying institutions in group IV that have healthy management, good management, that are profitable and solvent, yet they're in group IV, and to basically deal with those institutions in a fashion which would not be viewed a forbearance but would provide them with some time to improve.

Senator MACK. Mr. Chairman, if I could.

The CHAIRMAN. Yes, I want to stop on that point, too. You were going to ask a question on that?

Senator MACK. Well, actually related to these numbers here.

The CHAIRMAN. OK. Why don't you go ahead? Then I want to come back to this point about this management program which is not forbearance, but sounds like forbearance.

Senator MACK. OK. Since the numbers are always changing, can you give me an idea, Tim, how many institutions the RTC now controls and what their asset total would be?

Mr. RYAN. They have, I believe, and the numbers keep changing because we keep selling institutions each week and we keep moving institutions in—I think there's about 250 now, 246, I believe we have. Total assets—about $170 billion.

Senator MACK. $170 billion?

Mr. RYAN. Yes, sir.

Senator MACK. OK.

Mr. RYAN. But as you can see, that keeps changing. If we move in—for instance, this week, we moved five institutions. Last week, I think we moved 13. And the numbers can change. We moved 13—it was, I think, an increase of $11 billion.

So the numbers change radically each week.

The CHAIRMAN. You know, if I may just interject on that point, we asked Bill Seidman when he was here about the inflow, outflow side of the RTC because they're disposing of assets, and yet, they're getting new assets all the time.

And the rough numbers were that at the end of last year, they had roughly about $100 billion in the RTC, give or take, maybe it

was $106 billion. And so they've gotten rid of some assets, they've got new assets, but the level has gone up to—I think it was $164 billion 2 or 3 weeks ago and it sounds like it's about $170 billion now.

Mr. RYAN. $170 billion now.

The CHAIRMAN. So, in any event, they're getting more coming in than they're able to move through, so that that inventory in the RTC is about at that level now.

Senator MACK. And I would just ask one more question and maybe I'll just pick comparing group I to, say, groups III and IV.

As you look at those institutions, do you find a significant difference in either the asset structure of the institution and the liability structure of the institutions?

Mr. RYAN. The chairman hit the nail on the head in his opening comments. The asset structure is, by and large, of group I, which is half the industry, meet the fully phased-in QTL test. They're into the basic business. They've stuck with the basic business, and they haven't changed.

The liability structure is radically different between the group I's and the group III's and IV's. The cost of funds are lower for the group I. The level of broker deposits is lower for the group I. The level of borrowing from the home loan banks is lower for group I. And as you move down through the groups, you find that the liability structure changes and the cost of funds increase.

The CHAIRMAN. You know, it's interesting to wonder, if I could just pose a thought to you that you triggered in my mind. And that is, I'm wondering if in the group I's, we're finding any of the more exotic profiles that also were smashing success stories?

In other words, obviously, the predominant profile is the plain vanilla home lender. But are there examples of the more exotic mix of business activities that have been sensational successes?

Mr. RYAN. I would say the scariest part, to me, of this segmentation and looking at the numbers—and we look at them really closely—is that group II has more of the exotic type activities than you would think. And its balance sheet, the typical group II looks, from a balance sheet standpoint, more closely aligned to III's and IV's than I.

Senator MACK. There's one other thought that's rattling around. Let's see if I can pull it together and then move on.

At the beginning of all of this—that is, going back into maybe the late 1960's and early 1970's—the impression was that restructuring really had to take place because of the tremendous difference in the cost of capital and the long-term nature of the lending, 30-year loans with short-term liabilities that are skyrocketing.

And the conclusion was that we have to change the basic makeup of these institutions to allow them to become profitable.

But what seems to be coming out, what your comments were, that if institutions remained in what was historically the S&L business, lending on single family residences, those are the ones that survive, those are the ones that are strong, those are the ones that today are profitable.

Mr. RYAN. As you know, Senator Mack, I'm 6 months into this industry, but sometimes, with that limited amount of experience, you can look at things more simply and see them more clearly.

This to me looks like a very interesting niche business. And the interesting aspect here is that the group I thrifts have stuck to the basic business. The level of commercial lending is very low. And it's a business that more and more commercial banks want to get into.

It's one of the bigger surprises I've had, also, when you go out and talk to the commercial banks. They're acquiring thrifts because they view it as a business that's stable and a business where you can make some money in the future without some of the cyclical risks in some of these more esoteric areas.

Senator SHELBY. Mr. Chairman?

The CHAIRMAN. Senator Garn sought recognition, and so does Senator Shelby.

Senator Garn spoke to me just a moment ago, so let me call on him now, and then to Senator Shelby.

Senator GARN. I do not expect that you would have these numbers today, but I would appreciate it if in each of these groups, if you could supply the committee with the percentages of State versus federally chartered institutions. It would be my guess that, from the figures you supplied us a couple of months ago, that through June 1990, 73 percent of the total cost of thrift resolutions had occurred in State-chartered institutions.

So I would assume that the trend would continue and in group I, you would have a much larger percentage of Federal institutions as opposed to State, and in category four, the majority of them would be State-chartered institutions rather than Federal.

But, if you could break that down for the committee, my guess would be that this is what you would find.

The reason that I make that point, when you and Senator Mack were talking about exotic services and those who are traditionally in the business, I think you would find that it would show that most of those exotic services were allowed by State legislatures and not by the Congress of the United States with Federal institutions.

I would appreciate it if you would supply us with that further breakdown of these categories.

Mr. RYAN. I'd be pleased to supply that.

The CHAIRMAN. Senator Shelby?

Senator SHELBY. Thank you. Tim, in the group one category, are they regionalized or are these healthy thrifts that stayed with the fundamentals everywhere? And what size are they, generally? I know there are some large ones there, but——

Mr. RYAN. We have broken group one out and analyzed it pretty thoroughly, and we've reviewed it by domicile.

Senator SHELBY [continuing]. That's the good news you have, isn't it? Go ahead.

Mr. RYAN. A couple of comments. One is that, obviously, it's geared toward geographical areas where the economy is good. And it's geared toward States where there's a large percentage of traditional S&L's.

I can supply for the record a better breakdown as to geography, but——

Senator SHELBY. And sizes, too. Sizes of these.

Mr. RYAN [continuing]. Well, the size goes from the very largest to the very smallest. And it's really keyed more into the type busi-

ness they have had, the cost of funds, and the lack, quite frankly, of commercial lending in their portfolio.

One of the other aspects I think you'll find interesting is that, within group I, there is very, very little government support. So that from FSLIC-assisted transactions, total dollar value, less than 2 percent for the group I's.

Senator SHELBY. What's the average capital basis for group I? Just average. Do you have that?

Mr. RYAN. 6½, 7 percent.

Senator SHELBY. Pretty strong.

Mr. RYAN. 6.71. Yes, it's very strong.

Senator SHELBY. Are a lot of these located in the Midwest?

Mr. RYAN. They're really all over. They're all over the country, Senator Shelby. And their profits, the group 1 profits, about earnings, I think of about 70 basis points, very comparable to commercial banking. Exactly the same, in fact.

Senator SHELBY. You've also noticed the lack of wheelers and dealers in those institutions, haven't you, by the very nature of how they're run.

Mr. RYAN. I haven't met all of them, so I'm not ready to say that yet.

Senator SHELBY. But you're looking to see.

Mr. RYAN. If I can, Senator Heinz, just to correct the record here, the movements to group IV. There were two from group II and 19 from group III.

The CHAIRMAN. Now, if I may, I want to pursue two points here, and this is a very constructive conversation becase it's a hearing, but it sort of becomes a seminar on common understanding because we're still trying to unravel the dynamics of this situation.

And I'm struck by something that you said, Senator Mack, in terms of looking at this thing over time. What's the profile that's tended to do well and tended to thrive? And we find that it's the people that pretty much stuck to home lending.

If you come down through the late 1970's and into the early 1980's, you had that huge interest rate shock and you had the deregulation of interest rates and the rise of money market funds that were competitors, and so forth. And so you had this huge disintermediation problem with interest rates going sky-high with the Fed policies in the early 1980's.

And so you had this enormous fault line that caught so many people who had fixed-term mortgages out there, institutions that did. They were caught where they were having to pay a much higher rate for their funds and they were locked into low-yielding assets on the other side.

So, you had that fault line to have to navigate and to have to work through over a period of time.

Obviously, a lot of the predominant home-lending institutions managed to do it. Over time, somehow or another, they worked that problem out.

But there were two other factors that came along in there that were policy things that I think really had a major bearing.

They didn't by themselves adjust that mix-match problem which neeed a period to work its way through, hopefully, without somebody going down the drain in the middle of the work-out. But you

had securitized mortgages come along in that period, so that institutions could origiate mortgages, package them up, sell them off into the private market, and get rid of the interest rate risk, if you would, so that they weren't caught in that situation.

So they could become the originators and then unload the interest rates risk on somebody else.

And then you had variable rate mortgages come along, but it's very interesting. I was asking the other day, what percentage of home mortgage originals now are variable rate versus fixed-rate mortgages. It's about 70/30. That was a quick answer, so I wouldn't want to bet my life on it, but I was told that within the last 6 months, that roughly 70 percent of the mortgages originated were fixed-rate mortgages because people obviously want to know what they're going to be locked into. They don't want to get into a situation where they get into another interest rate spike, and all of a sudden, their mortgage payments double each month and they lose their house because they can't make their mortgage payment.

So, in any event, you had those two developments come along as sort of policy developments that were interdicting this business, the plain vanilla sort of home lending business during that period of time.

There are a lot of other factors as well. But I think in terms of understanding, trying to fathom what's gone on in this industry and where we are today, and what are the dynamics that are going to work for the future, it looks to me as if the devices that are now available do allow S&L's to manage the interest rate risk, if they're competent. If they know what they're doing.

They can either package up these mortgages, turn them over quite rapidly so they don't get trapped off-base with this adverse spread. Or they can somehow, again, if they're smart enough to be doing it in their business mix, go to these variable rate mortgages, if they can convince people to buy them, and if they're going to hold them in their own portfolios, sort of manage it that way.

But I'm just thinking aloud because, in trying to sort of fit all of this together over a time line as to what enabled some to make it and some not, I think those are key factors.

If I can pose this question to you, Mr. Ryan. You mentioned, and this is key, in my view, the so-called management program that Bill Seidman made a reference to the other day and a lot of ears perked up around the table and Kit Bond, particularly, was interested in it, as we all are.

And you just said a minute ago that there are apparently some different points of view that you would have or the OTS would have, and the FDIC would have, with respect to what would constitute a "management program" for the ones that are in, say, in category 4, that isn't forbearance, per se, in the old sense, but nevertheless, as some kind of a work-out plan, to take the institution that does have its head above water, does have competent management, does have decent business prospects.

Now, tell us where that discussion is. I'd like to know how you see what constitutes some kind of a "management program," or whatever phrase is being used, and what the FDIC sees as a management program and where is the overlap and where are the differences?

Mr. RYAN. For the last 3 months, we have been discussing this issue. Mostly, the chairman and I, just alone, some with staff.

Where we are right now is, we're trying to further segment group IV. So we're in the process of doing that right now. We're trying to identify those institutions that clearly deserve to be transferred and should be placed on the top of our list for transfer.

The CHAIRMAN. Into the RTC.

Mr. RYAN. Into the RTC, right. We're trying to further segment group IV into institutions that would be appropriately qualified for our accelerated resolution program, which is essentially an M&A preconservatorship program.

We're in the middle now of our pilot project. We have nine institutions that have been in our pilot project for about 40 days. We've had bidders' conferences for almost all of them. They're now formalizing the due diligence and we'll have to see how it works out.

We don't know. We have a couple of problems, principally because we're trying to identify and market almost all of the assets, either on a whole bank basis or to sell the assets at the same time that we're selling the institutions, because, as you know, and as all members of the panel know, our biggest problem at the RTC is moving assets.

The CHAIRMAN. Right.

Mr. RYAN. The third segment of group IV would be those institutions where the management is acceptable. They're not losing money. In fact, they may even be making money, and they're solvent. The Government would just have to make a decision as to whether or not we should appropriately keep these institutions alive or transfer them to the RTC.

My own personal view is that this is not an easy issue.

The CHAIRMAN. No, we appreciate that.

Mr. RYAN. Because we can see just from the statistics I've been presenting here, and by the quarterly presentations we've been making, that the one thing that's working in FIRREA short term—I have a comment longer term—but the one thing that's working short term is that we are moving institutions out of the private sector into Government control.

Even though we're moving institutions principally on insured deposit transfers, we're still moving them.

Short term, we're seeing consolidation. I think the most positive aspect of what we're doing here longer term is the consolidation that's taking place in the banking industry. Very positive impacts, in my view. And that is definitely happening.

It's happening because of the sale of thrifts to banks and other stronger thrifts and it's happening for the same reason in the commercial banking area. And that's probably long-term good for the country.

The CHAIRMAN. Let me ask you one other question.

In terms of that third group that you just described, which might be the candidates for a management program——

Mr. RYAN. He calls it supervisory management program, SMP.

The CHAIRMAN [continuing]. OK. Good. We've got a name for it.

Mr. RYAN. That's important in Washington. We have a name.

The CHAIRMAN. Now, I'm interested, if you give me a rough sense, as to how many institutions would seem to fall within that boundary line.

But more than that, I'm not so much interested in the number of institutions. I'm really interested in the percentage of assets represented in category 4 that might in fact fall into this difficult-to-judge group, where maybe it's going to cost us less to the Government if we can keep them going and let them earn their way back to a stronger position rather than cash them out, dump the assets into the RTC, and then increase the size of the junk pile that we're having a very difficult time getting rid of. We can't even seem to get an auction going because the problem is so difficult.

So would we be talking about—I would assume that we're talking about several tens of billions of dollars of assets in institutions in that group; otherwise, I wouldn't think that you'd probably be spending that much time at it.

I mean, not that it isn't important, but you've got a lot of things to deal with. I assume you think there's the potential to save some real money there, and that's why you and Chairman Seidman are talking about this, to try to see if you can come up with some kind of a set of criteria or some way to judge what might qualify for this SPM program.

Is that a fair summary?

Mr. RYAN. It's a fair summary, and I think it's also fair to say that the only time we spend on an issue like this is spent because we feel that we can save taxpayer funds.

That is the principal goal for all of our actions. I can provide sometime in the near future statistics and numbers as to the breakdown into the three groups, the three further segments of group IV.

I don't have it right now. I can say that the chairman has told me that FDIC, during their reviews of thrifts, identified 60 institutions that would now be in group IV who would be eligible, in his view, for the supervisory management program.

We have not reviewed that list closely with him yet, so I don't know whether I would agree with the 60 number or not.

I also assume that the numbers would be reasonably good as to the size of the institutions. If we're going to spend this much time trying to manage institutions, I'm sure we're not going to spend it on small, $100 million institutions. That just wouldn't be a good use of our time and energy.

The CHAIRMAN. And tell me again how many institutions are in group IV at the present time.

Mr. RYAN. At the present time, 211.

The CHAIRMAN. 211. So of the 211, roughly 60, at least on Seidman's list, seem to qualify for the possibility of going into this SPM status. And your view is that the 60 are probably among some of the larger ones, or you wouldn't be spending the time at it.

I would guess that even if you used a rough multiplier of some number of billions per institution, that you've got to be talking here about several tens of billions of dollars in assets.

Wouldn't this be at least probably $50 billion worth here, or something?

Mr. RYAN. I'd be glad to supply that to you, Mr. Chairman.

The CHAIRMAN. Is anybody on your staff able to give any kind of an educated——

Mr. RYAN. I don't think they're able right now. They may have their views, but I've been doing more work on this than any of them.

The CHAIRMAN. I see.

Mr. RYAN. And I know that we don't have a number.

The CHAIRMAN. All right. I appreciate that. Since we started, Senator Mack has joined us, Senator Graham has joined us. And while we've got a break here, do either of you want to make any kind of an overall comment?

Senator MACK. I do not.

The CHAIRMAN. Did you, Senator Graham?

Senator GRAHAM. I do not have an opening statement, Mr. Chairman.

The CHAIRMAN. All right. Why don't you continue then, Director Ryan?

Mr. RYAN. All right. I'm going to switch gears here now and move from kind of a review of the industry into just some brief description of our regulatory——

The CHAIRMAN. Well, excuse me. One other thing. I'm sorry, and I apologize.

I want to have us understand where you and Seidman are in these discussions because you left the impression that after a series of meetings, you tend to have a view right now as you see these, say, 60-odd institutions, maybe the number is a little different than that. He has a somewhat different view. You're sort of going back and forth to try to come to a common view or——

Mr. RYAN. I don't really think we have that different a view. We're all trying to do the same thing, and that is to save taxpayer dollars.

The chairman has an operational hat that he wears for RTC. I have kind of an overview RTC hat. And some of his decisions and recommendations are made with more of the operational RTC issues in mind. And that tends to push you toward one decision.

I have another hat on with OTS, and the one thing I know is happening here is that, as we move institutions out of the private sector and into the RTC, we are providing an opportunity for those private sector thrifts that can make it, to operate in an environment which is probably geared more toward success than not.

So that's why it's a troubling issue for me.

The CHAIRMAN. Yes. Here's what I'm driving at. I'm not trying to accentuate differences between the two of you. I'm trying to figure out how close we are to a common view. And as you see it, do you and he together sort of have the power to come up with a format to make that judgment, or once you do that, does that have to be blessed by somebody else?

Where are we in that process? When will that get settled, and does it just involve the two of you settling it or does it have to be—does Brady have to approve of it?

How does that get settled?

Mr. RYAN. Once we come up with a position, which should be very soon, the reason we're segmenting group IV into those three other classes is so that we can get this thing set up for decision.

Initially, it will be our decision. We will no doubt solicit the views of the RTC board. We will also solicit the views of the oversight board, since they're, from a policy standpoint, looking at RTC activities, and this impacts RTC.

My own personal view, and I'm sure that the chairman's view is, that we will solicit the views of this committee and the committee on the House because this is somewhat of a modification to the FIRREA fix, if you will.

The CHAIRMAN. Right.

Mr. RYAN. So my own personal view is I'd like to get this to a point where we actually could give you an idea of exactly what would happen to how many institutions with how many assets, and then outline if there are options here, the options, and how we feel about it.

The CHAIRMAN. And what would you guess? Thirty days away?

Mr. RYAN. I would think that within that time period, we'll finish this.

The CHAIRMAN. Very good. Senator Kerry has joined us as well.

Senator Kerry, did you have an opening comment you wanted to make?

Senator KERRY. Mr. Chairman, I do, but I'm going to forgo it and I would simply ask that it be placed in the record in full.

The CHAIRMAN. Very good. I want to thank my colleagues for their patience. I wanted to try to pin this down because this question of forbearance by any other name I think is an issue that we really need to understand. Just so we're tracking together here. I think it's very important that we have a record that lays it out in as much detail as there is.

So I appreciate your being forthcoming on it, too. Senator Mack?

Senator MACK. If it's appropriate, I still have a couple of questions having to do with——

The CHAIRMAN. Please do.

Senator MACK. OK. One of the things that I've been hearing around Florida is about the interest rate differential—that is, that the poorly run institutions were paying higher interest rates and people would put money into the poorly run institutions because they had the guarantee of the deposit insurance—and after the RTC started acquiring these institutions, that the interest rate differential was still there, and that there is still the transfer, if you will, of deposits from well-run institutions now to the RTC.

Is that taking place and is that having an impact? Will that have an impact on categories that, say, 3 and 4, or maybe even all of them?

Mr. RYAN. It is happening. It's happening in certain States.

I know that it has been happening in Texas. Whether it's happening in Florida or not, I really can't say, Senator Mack.

One of the things that, putting my RTC hat on here—we've been trying to move institutions quickly out of the RTC because of the fact that they compete against the healthier institutions, and as you've noted, they kick up the cost of funds basically through increasing interest rates. And in some States, like Texas, they're very interest rate sensitive. I don't know whether that's true in Florida.

I know my mother, when she lived there, she was interest rate sensitive.

Senator MACK. I can assure you that it's very interest rate sensitive.

Mr. RYAN. So that does have an impact on the healthier institutions.

Kind of an interesting comment here, though, is that the healthier institutions know how to manage that. They know that at times you just have to forgo deposits because it's too expensive. And that's why their cost of funds are lower.

Senator MACK. Well, maybe we can pursue that further.

Mr. RYAN. This will give you—this is an interesting statistic here. These are the average cost of funds by group: 7 percent for group I; 7.3 for group II; 7.4 for group III; and 7.8 for group IV.

Conservatorships, 8.4. So, as you can see, again, there's direct correlation.

Senator MACK. I'm not sure at this point that I'm skilled enough to follow this discussion further. But it's one that I do want to pursue.

The last point that I would raise and, again, the thing that caught me in your testimony about group II was the return on assets.

The return on assets, if I remember correctly, was four basis points. To equate that, in commercial banking, return on assets, the goal that most of us have was a return of 1 percent or basically 100 basis points.

That suggests to me that group II is much, much more vulnerable than hit me when I first looked at those charts. Six hundred seventy-four institutions with $352 billion in assets, net quarter income, second quarter, $31 million.

What could happen very easily, from looking at that, is that group II could very easily—I mean, there could be a real transfer into group III in a relatively short period of time, given the conditions of the economy, given the conditions with respect to interest rates and the real estate market.

I guess I'm saying, when I first looked at those charts, I was somewhat hopeful. I kind of combined II and III and said, these institutions are doing all right. But the more I looked at it, the more I have a tendency now to look at group I as separate, and groups II, III and IV are the ones that we really have to be concerned about.

Mr. RYAN. The group II number is obviously a range, so that there will be some in group II that are significantly in excess of that return on asset that you just noted, and there are others that will be less than the median.

Obviously, at the low end of group II, given the nature of the economy, especially regional significances here are important, if the real estate market continues to deteriorate, then some of the low end group II's will probably move to group III, and some of them, if it continues, could move to group IV.

But at least, on average, we, again, in segmenting the industry, we have to look at certain institutions and allocate our time based on where the real need is.

Senator MACK. And I assume your reaction would be also that with 5.2 percent, I assume that's tangible net worth.

Mr. RYAN. That's tangible net worth.

Senator MACK. With 5.2 percent of tangible net worth, obviously, they've got a longer period of time that they can deal with the issue.

Mr.,RYAN. Correct.

Senator MACK. OK. All right.

The CHAIRMAN. Tim, I'm going to have you go ahead and try to give us the rest of your perspective. We've gone into this because I thought it was important to do so.

Mr. RYAN. No, I think it is, too. Take as much time as you want.

The CHAIRMAN. And I want to do the same thing. I want to say to all members, as you're going through the remainder of your presentation, if we come to an electric moment where somebody wants to get into it, people should so indicate.

Why don't you go ahead.

Mr. RYAN. Thank you. As I previously mentioned, the financial regulatory agencies have all agreed on a common leverage ratio standard and OTS has joined in the adoption of that standard.

I'd like to express my full support for these higher leverage ratio requirements. A leverage requirement is an important back-stop for the risk-based capital rules since the risk-based rules do not address the major risks that banks and thrifts face, principally interest rate and operational risks.

The higher leverage ratio requirement, combined with the increase in the risk-based requirements, taking effect on January 31, 1990, end the phase-out of certain impermissible investments through 1994, present a significant and complex challenge to the savings and loan industry.

More institutions will be required to file capital plans with OTS. Many will face new regulatory constraints on their ability to grow and to pay dividends.

A significant number of savings associations will have to retain more of their earnings or shrink to meet their capital requirements.

I'd like to discuss supervisory philosophy.

We are critically reexamining our supervisory philosophy. OTS is being confronted with the clear need for increased supervisory activity without increasing the cost of the thrift industries to the point of impairing its financial condition.

The examination process is our most important supervisory tool. We are deploying our staff resources toward that function so that we increase the total number of examiners and the frequency of examinations.

OTS presently has 2.2 institutions per examiner, which compares favorably to the OCC, which is essentially a 2:1 ratio. And I have committed to improve that ratio.

We're also increasing the frequency of our examinations. Effective immediately, we will examine at least annually all savings and loans, first over one billion in assets, second, those over $500 million in assets operating under approved capital plans, and all institutions that are rated macro-3, 4 or 5.

That's in total in excess of half the institutions that we supervise. All other S&L's will be examined at least every 18 months.

Agency restructuring. OTS must restructure and streamline its operations. Our recently announced regionalization plan that con-

solidates the agency into five regional offices and a Washington headquarters is a critical step in this direction.

A new decentralized regulatory structure should eliminate redundancies and reduce costs, enabling us to lower our assessments in the future.

The agency restructuring promotes decision-making by front-line personnel who have the most intimate knowledge about the safety and soundness of the institutions that we supervise.

Mr. Chairman, I'd like to also discuss our enforcement philosophy.

FIRREA greatly expanded the agency's enforcement powers and authorities. One of my top priorities when I took office 6 months ago was to make sure that OTS had a vigorous enforcement program. Our enforcement philosophy is very simple—the fiduciary duty of directors, officers, and agents of a financial institution such as attorneys, accountants, other professionals, extends beyond their duty to the institutions' common shareholders. These insiders also owe fiduciary and professional duties to the Government because it is the Government that will ultimately bear the losses resulting from excessive risk-taking.

The possibility that fiduciaries and other managers of troubled or failed savings associations may avoid the full effects of justice by transferring or concealing their assets is one of the difficulties that we are facing.

We recently undertook asset freeze actions in courts in regard to Mr. Tom Spiegle, formerly of Columbia Savings, and Mr. Charles Keating, formerly of Lincoln Savings and Loan.

To give tne asset freeze policy the effect of an explicit statute, we urge an adoption of the omnibus crime bill containing an appropriate new statutory subsection.

And we certainly appreciate your assistance in that regard, Mr. Chairman, and your staff.

The CHAIRMAN. Thank you. We have it in the bill. Now we've just got to get it out of conference and signed into law.

Mr. RYAN. The effectiveness of OTS enforcement actions is predicated on close cooperation with the Justice Department. We recently provided the Justice Department with a list of the top 100 criminal referrals. We understand from the Department of Justice, and this is information as of last evening, that grand juries have already indicted 79 defendants from 47 different institutions on our list of 100.

Investigations are ongoing with respect to all of the other institutions.

OTS also will open many enforcement matters to the public record. In July, we announced that administrative hearings on enforcement actions involving closed or RTC-operated thrift institutions will be open to the public, barring a compelling reason for confidentiality. We will continue to be aggressive in our enforcement actions.

I'd like to now turn to structural changes which you asked me to address, Mr. Chairman.

The committee has requested that I express my views on many structural changes that I think Congress should consider in the

future, including modifications to the depository insurance system or financial regulation.

I'd like to say up front that my testimony should in no way prejudge the comprehensive Treasury Department study on deposit insurance and financial services regulation reform currently under development. So these comments are my personal views.

As to deposit insurance, there's no shortage of prescriptions for deposit insurance reform. Congress has recently heard from both Chairman Seidman and Chairman Greenspan on their preferred approaches to deposit insurance reform.

Let me give you my preliminary thoughts.

Philosophically, I support measured government efforts to shift the risk of losses away from the Government and the taxpayers and toward shareholders and debt-holders of insured institutions where, in my view, it appropriately belongs.

I also fully support the administration's draft legislation entitled, the Deposit Insurance Fund's Flexibility Act of 1990, that provides the FDIC with significantly greater flexibility to set assessment and rebate levels for insured institutions.

I have some fundamental concerns about the concept of too-big-to-fail that, in effect, insures all depositors in large—read that, very important—financial institutions.

Certainly, this is a difficult issue. Basic principles of fairness and equity argue against the protection of uninsured depositors and debt-holders.

Deposit insurance seems to me to be most appropriately applicable to small depositors. On the other hand, Chairman Greenspan articulates a persuasive position that the failure of some very large banks may be so disruptive to the financial system that the Government must make an exception and cover all deposits.

I'm also concerned about the ramifications of lowering the $100,000 limit for deposit insurance. Transition costs and funding disruptions may outweigh its benefits.

The congressional review of existing coverage of multiple accounts is also, in my view, very prudent.

Finally, I support a thorough review regarding the continuation of pass-through deposit insurance to pension plans and money markets.

An aside here, Mr. Chairman. I spent sometime yesterday and last evening reading your floor statement for your bill and I, on the way over here, looked at Senator Wirth's introductory statement and his section-by-section submission.

And just a very candid, brief comment. I think that, and I'm not in a position to adopt any provision in anyone's bill. I think that decision is made way above my pay grade. But I think the debate that you have stimulated and others have stimulated is very, very useful. I think that, in a cogent presentation, which is also reflected in your review of the S&L industry, post-FIRREA, was very, very useful. So I urge you to continue the kind of full, in-depth discussions, because on many of your points we share similar views.

The CHAIRMAN. I appreciate your comment and I've been noting that today as you've been testifying and as I read your statement, it looks to me like we do see a lot of these things the same way and

it's very important that we try to get ahead of the curve with respect to the stresses and the problems out in the banking system.

I think your serving in this duty station and drawing the lessons out of this experience and helping us apply some revised ground rules with respect to the broader financial institution issues, I think is one of the great services that you can help provide, so that we don't repeat this experience unnecessarily.

Obviously, the banking situation is different in certain fundamental ways, but a lot of the underlying factors that are at work that helped sink the S&L industry are also, unfortunately, at work with respect to the pressure on the banking system.

And so, I really welcome your thoughts on this and I appreciate your comments.

Mr. RYAN. We have two guiding themes in everything we're doing at OTS.

One is never again. And two, to save taxpayer funds. That's what's driving all of our decisions.

I'd like to discuss just for a minute the savings bank charter flips which you discussed in your opening because it troubles me greatly.

When I appeared before this committee in June of this year, you expressed outrage regarding the disproportionate amount of losses to the insurance fund that occurred due to the activities of State-chartered thrift institutions in Texas, California, and Florida.

In 1988, 1989, and early 1990, the FSLIC and RTC resolution costs for State-chartered thrift institutions in these three States alone were 74 percent, 70 percent, and 57 percent of the total resolution costs, respectively.

You called these powerful numbers and I agreed with you.

Now, I am greatly concerned because there is a movement afoot in a number of States to pass legislation creating a savings bank charter that is designed to allow many institutions that we know today as savings associations to escape many of the FIRREA reforms.

In Illinois, for instance, the Governor has recently signed the Illinois State Chartered Savings Bank Act, an act which I urged him to veto. We oppose this and similar State legislation because we believe that they are intended to create a mechanism for depository institutions that were clearly within the purview of Congress's FIRREA reforms to escape the reach of these reforms.

This constitutes an impermissible effort to circumvent FIRREA, and we, accordingly, will seek to prevent charter changes under statutes such as these.

When it addresses structural reform, Congress should consider making explicit what we believe is clearly implied by FIRREA, that states should not be permitted to create or maintain parallel systems of depository institution regulation that undermine reforms undertaken at the Federal level.

The CHAIRMAN. Let me just say, I want to really commend you for your leadership on this because you've got enough other things to do that it would be easy to be distracted or to stay silent on it.

But the fact that you've spoken out on it and that you made a recommendation to the Governor of the State of Illinois I think is a

very important initiative on your part. I appreciate the leadership on this issue, particularly, and I think you're dead right.

Senator GARN. May I add something, Mr. Chairman?

As one who continually has to read how the 1982 act known as Garn-St Germain is a major cause of the problem, even though it is still the law of the land. Your latest figures also indicate over a broader period than your last testimony, from 1982 through 1990, 74 percent of all the thrift resolution costs are in State-chartered institutions.

I've always been a State's rights person but I've had a belly full of these State legislatures. So you think you want to be tough on the States, you've got a chairman and a ranking member up here who agree. The States can do any damn thing they want, but not with Federal insurance.

We're just not going to put up with that crap any more, to put it bluntly. If that isn't a strong enough message for the Governors and the State legislatures, I'll make it stronger.

Senator GRAHAM. Mr. Chairman, could I ask a question?

The CHAIRMAN. Yes, of course. Senator Graham?

Senator GRAHAM. I understand the Federal insurance agencies currently have the authority to deny insurance coverage to both Federal and State-chartered thrifts if they consider them to be an excessive risk to the fund.

Is that correct?

Mr. RYAN. We do have very broad authority at the FDIC.

Senator GRAHAM. Well, if you sense that States may be taking action to create a new charter which would represent such an undue risk to the insurance fund, is FDIC considering denying insurance to those institutions?

Mr. RYAN. I've urged my colleagues to look at that very closely, Senator Graham.

Senator GRAHAM. Why should it be a closed question as to whether they do that or not?

Mr. RYAN. It's not for me.

Senator GRAHAM. Is there anything that Congress needs to do beyond what it has done in order to clearly indicate to the insurers that just because an institution is chartered, does not mean that it has a God-given right to also be insured by the Federal Government?

Mr. RYAN. I think some of the comments that you gentlemen are making today will be very helpful in that regard.

The CHAIRMAN. Senator Graham, I think what we need to—this is very illuminating. We're getting a lot of important information today and that's the value of an oversight hearing of this kind.

I think that you raise a very good point about the fact that the power to withhold insurance, I would think lawyers would have to advise us, is present under existing law.

But I fully intend that we will inquire as a committee in your name and mine and Senator Garn's and the rest of us, to establish that very clearly, so that this isn't a situation where there's a Catch-22 where somehow or another there's a gap and through the gap great difficulties arise, because I intend to see to it that that doesn't occur. And certainly, it was not our intention that that occur when we wrote the law as we did.

Senator GRAHAM. If I could, this is collateral. But there is, my information, at least, one statutory gap, and that is that FDIC is required to provide insurance to federally chartered commercial banks. They do not have the option with those institutions that they have with thrifts or with State-chartered commercial banks.

Legislation has been introduced to eliminate that anomaly, and with the objective of giving to the Federal insurers across all the range of institutions the capacity to make an independent underwriting decision from the chartering decision made by other agencies.

I would hope that we would have a clear standard that the Federal Government is under no obligation to insure every institution that other Federal charters or that State charters will make available.

Senator GARN. Mr. Chairman, if I could make one more comment.

The CHAIRMAN. Yes, Senator Garn.

Senator GARN. I think it should be so tight that it's very simple. And if we have to make it statutory, that if you exceed any powers allowed in Federal law, you are not allowed to have Federal insurance.

Bill Proxmire was in favor of that when he was chairman of this committee. I was. Bill tried, as you remember, in 1986, when he became chairman again in, 1987, and 1988, tried to do that and was not able to do it.

But I think we should take away the discretion of the regulators and simply put it in statute that if you want Federal insurance, you comply with Federal law on powers and authorities and activities that you're engaged in. And If you're not willing to do that, then, fine, you don't have Federal insurance.

The CHAIRMAN. You know, on this point, I'll just add another thought, and that is this has been a very sore subject with me for a long time on this question.

I will say on the other side that what happens is that the Governors and the State regulators come in and they say the dual banking system has had certain virtues and advantages over the years and that it's allowed innovation, money markets, checking accounts, NOW accounts, and I believe variable-rate mortgages started out that way as well.

So they have a side to their argument.

I don't find that side of the argument compelling enough, given our experience, to allow Federal deposit insurance to stretch out over any number of variations of activities that any one of the 50 States might engage in.

And so, there's a very interesting colloquy on that topic with your predecessor. Two times ago, Ed Gray, back in 1985, was here sitting right where you are today and we got into a lengthy discussion on that with respect to State powers.

At that particular time, the suggestion that I made to him was that we should only take Federal deposit insurance as far as the Federal charter allowed activities to take place. And if the States wanted to go beyond that, that they would have to take on the insurance obligation for any additional activities that they wanted to authorize.

So we talked about that at that time. And, of course, the thought was of the regulators that there was a different way to get at the problem, that you could somehow manage the risk profile without sort of segmenting it up and sort of sticking the State with the direct obligation for what they wanted to add on in the way of activity.

But I think post the experience of the S&L system, and now even the tremendous stress that the bank insurance system is under, I don't think we can any longer afford to have these Federal deposit guarantees or these Federal Government sort of blank-check back-up arrangements in place for activities that are set in motion by other units of government, whether they're State levels of government or what have you.

That's not to be disrespectful to them or their creativity or what have you. I just don't think we can adequately necessarily monitor and track that activity.

When I look at the data, the thing that really blew the hole in the side of the savings and loan system, there were a lot of problems, but the thing that really blew the big gaping hole and that sunk the ship were the losses in the State-chartered institutions. The numbers are overwhelming.

I don't think that was ever fully understood or really on the radar screen of the national government to the extent that it should have been, by anybody.

So now, we're in the midst of a recontruction. We're going back and saying, what sunk the Titanic? And there are a lot of different elements to it. But that problem was one that grew to a size that I don't think anyone fully comprehended.

It's interesting, you've testified today that when you came in yourself with a fresh perspective, and you've gone, you've been doing the detective work to try to reconstruct what happened, the magnitude, the percentage magnitude of the losses that have come out of the State-chartered institutions has really kind of taken your breath away.

That's not your phrase, it's mine. But you've in effect said that today.

If you could imagine for the moment, if we could just take that part of the problem away and just be left with the rest of the problem, we'd have a problem of a startling different dimension. It would still be a big problem, but it would have been one that we could have handled and dealt with in an entirely different fashion than the problem that we now find ourselves in the aftermath of.

And so, I think—and the reason it's important to take the time on this point is it goes beyond just the savings and loan and the banking system and shearing off these thrusts by States like Illinois and others to take a ride on Federal deposit insurance.

But we're now asking this question here with respect to other Government-sponsored enterprises because we have a lot of variations of this in a different form where we've got the guarantees of the Federal Government on the line for activities that we are not always able to monitor very well. The dimensions, the build-up of unfunded liabilities we don't always see ahead of time on a timely basis. And then we wake up one day and we have enormous un-

funded liabilities out there that all of a sudden have to be dealt with.

So the policy issue here, the underlying policy issue is it has an application out of the S&L experience, I think into what's left of the S&L industry and into the banking industry. But even more broadly than that, with respect to other obligations in the future, where I don't think the country is in a financial position to take any more hits of this size.

I mean, we're having a tough enough time handling this one. I don't think we can leave ourselves in that risk position. I don't think we can obligate the Federal taxpayer for those kinds of risks in the future. I don't think it's—I just think it's unsound public policy to do that.

So we've got to be smart enough to draw this lesson out of here so that we fence these activities properly because no matter how good the regulatory system is—you know, you've told us some of the new regulatory mechanisms that you put in place. We before have taken the salary caps off so that we could have more good people of a higher skill level, professionally trained and so forth, out doing these examinations.

I don't think you can put enough regulators in place to adequately regulate and supervise that range of activities that go out into what is sort of off our radar screen, whether they're State-authorized activities or other activities that become so far reaching and so far ranging, that it's very, very difficult to get even a supervisory regime into place that on a real-time basis, can keep track of it all.

I'll give you another example.

Senator D'AMATO. Mr. Chairman?

The CHAIRMAN. If I may say just one thing, just one other example.

Senator D'AMATO. I want to put my statement into the record, if I might.

The CHAIRMAN. By all means. I was hoping you were going to stay.

Senator D'AMATO. I thank the chairman. I want to say that I think both you and Senator Garn have touched on some things that have to be done, and sooner rather than later.

The CHAIRMAN. Before you leave, Senator D'Amato, I just want to make one other point on this, and then I'll finish because I don't mean to monopolize this time.

And that is that we just had a bank, a major bank in this country that 90 earlier was not on the problem list, that within 90 days, was in the tank.

Now that's a commercial bank. And you sort of say to yourself, we've got all the supervisory regime in place, we've got all these people out doing all of these examinations. We've got the private accounting system. We've got this, that, and the other.

How can it be that you can have a situation that could go from looking fine and dandy and in 90 days be in the tank?

Senator D'AMATO. Well, Mr. Chairman, you raise a point there, and I don't mean to attempt to answer that question in the completeness and thoroughness that it might deserve because you would discuss that for a long time. There are many factors.

But let me just point out one thing.

I really do think, to a certain extent, the regulators are exacerbating the situation. They live in total fear of being criticized for not coming down hard enough, and consequently, in certain areas, have gone to an extreme.

Now, you can talk to some small community banks, as well as some of the larger banks to find out exactly what's taking place. Now we're talking on the commercial side. I have to tell you something—that that's going to be, we will make a depression. We will force marginal banks into the area where they are no longer marginal.

If you're going to start this business of the value of the asset as it is now, recognizing that you're in a downward trend, not only as it relates to real estate, but into other areas, you will literally force most of the banks into, at the very least, very marginal weak positions. And that's what's taking place.

Now the banking systems historically, not just in the United States, have existed on the basis of there being a faith in their ability to deal with the situations. And they have at many times had negative values.

Now all of a sudden, we've come to say, sure, we want good capital there, particularly if we're going to put taxpayers' money at risk. But we can overdo this to the point that we can make the failures, guarantee the failures instead of giving the ability to work out some very difficult situations.

So I'd just add that. I don't know where the balance is. But I have to tell you I think that we have gone from one extreme of the total laissez faire of the State regulators not doing and not being in command of the situation, to the extreme now that it's cut off everybody's head who looks like they're weakened.

And I don't think that that's a good position. And that's where we see it. I know it's not the political thing to say because the next thing I know, I'll be accused of somehow coming down in favor of letting the bankers do anything at any time with no supervision.

That's not what I'm saying. I am saying, in situation after situation, you will find where the regulators have so intimidated the banks, that they are not able to use good, sound business judgments dealing with the situations at hand.

And I daresay that that will result eventually in the taxpayers picking up a much bigger burden than they might otherwise.

So where's the balance? I don't know. But I don't think it's in—and by the way, I want to say this. I think that, Mr. Ryan, your group has basically participated in that same kind of thing—off with your heads kind of mentality. It's easier.

You don't want to make judgments. Why should you want to make a judgment? You don't want to be held accountable. You don't want to have somebody saying, how come you let X, Y, Z continue? You should have closed them down.

It's a lot easier. Don't have any flexibility. Don't have any business judgment. You just have a situation where you say, off with their head.

And if I were in your shoes, maybe I'd want the same thing. I don't want discretion because I don't want to be held accountable. I don't want somebody second-guessing me and saying I did a lousy job.

So the best thing is to have some rule, inflexible, doesn't take into account various situations, and you'll wind up putting more and more banks into more and more distress and more and more billions being chalked up to the taxpayers, and that's what's happening.

That's one person's observation. Maybe a little simplistic. I understand. But after all, I tried to do it within a period of time that would not be too onerous for those who are here.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator D'Amato.

Senator GARN. Mr. Chairman, if I could just insert something in the record at this point.

A few moments ago, I made the point that from 1982 to 1990, 74 percent of the FSLIC and RTC resolution costs were by the State-chartered institutions.

My staff has made available to me your release, Mr. Ryan, of September 10. These pie charts which break down those losses year by year. I think they're very revealing. That's why I'd like to include them in the record, because if you look back to 1982, 1983, and 1984, in that period, you find that Federal losses were a bigger proportion than State-chartered losses.

I should indicate that the problem in those years, as I well remember, was interest rate mismatch. Nobody was talking about exotic services.

The total losses in 1982 were $806 million, of which $500 million were Federal. The proportions in these pie charts indicate that it shifts. As you go through each year, it is shifting from a Federal problem for those reasons to a State-chartered problem—virtually entirely to the two States of Texas and California.

By 1988, you've got $31 billion worth of losses, of which $17 billion are in Texas alone, and $5 billion in California.

Those are very revealing. It shows the pattern of exactly what has taken place over those years, and that's why I can come down so hard. I believe in a dual-banking system, I believe in innovation, I believe in State legislatures, being able to do anything they want. But not with Federal insurance. You set up your own insurance fund if you're going to go off into these exotic services.

So, Mr. Chairman, I ask unanimous consent that these figures and charts be placed in the record.

The CHAIRMAN. Without objection, it is so ordered.

Yes, Senator Graham?

Senator GRAHAM. I just want to come back to this issue. I think there are two questions here.

One is, should we have a dual-banking system? Should the States have the authority to charter independent of the Federal?

I support that. I think it has made many contributions. I think the issue the moves to the underwriting. Should the Federal insurance fund be obligated to insure every institution every State is willing to charter?

I understand the law prior to FIRREA was that the old FSLIC was obligated to insure every State-chartered institution.

Is that a correct statement?

The CHAIRMAN. Well, I think essentially that's correct.

Mr. RYAN. By and large.

Senator GRAHAM. I mean, were there any exceptions to that statement?

Mr. Ryan. I don't really know, Senator Graham.

Senator GARN. Yes, there were some, Senator Graham, in terms that they did have to meet certain standards. So I think the answer, by and large, is yes. There were some State-chartered institutions. There's an example in my own State, five of them that failed that did not qualify for FSLIC insurance.

But for the vast majority of them, that is correct.

Senator GRAHAM. I think the onus, then, lies clearly here, that we need to legally separate chartering from underwriting. And second, we need to be very certain that the underwriters are fully aware of their responsibility to make independent judgments and that they vigorously carry out that responsibility.

The CHAIRMAN. Would you yield at that point? This is, again, sort of in the nature of a seminar where we're thinking aloud about it.

There's a question in my mind as to whether any Federal apparatus can sufficiently monitor 50 States going in 50 different directions on this issue where you've got Federal deposit insurance underlying it.

I don't know that in a real-time basis you can get enough examiners and investigators and others out there and that you can make sure that you're dealing with honest accounting statements and so forth to do it.

And so, when I start weighing the trade-off on State innovation in a given State out of the 50 States versus the risk to the insurance fund of a system that can start to slip away from us, I'm more and more of a mind to say that the Federal Government ought not to be in a situation where it's underwriting in effect through its insurance fund activities that I'm not sure it can properly track and keep track of on a real-time basis.

I just think it's too big an administrative load and I think it's better to shear it off. I think it's better to say, the Federal Government will stand behind activities that we feel competent to put into the law and see as sort of the business charter, and so forth. And if a given State wants to go beyond that, they're on their own hook.

I mean, I don't mean to make it sound as if it's an absolutely clear-cut yes/no situation. But I think, in my own mind, at least, the balance of judgment today is very much on the side of saying, I don't want the Federal Government signing up to anything that it can't define itself and competently manage and supervise.

If we want to let States innovate, I could see a situation where you might say in a given State, well, let's let a State try this on an experimental basis. A State might try with the approval of the FDIC or the OTS or the Comptroller of the Currency. Maybe a group of banks in a given area on an experimental basis could try something.

So that you've got a very tight fix on it. You look at the risk profile. You go through a trial period. You get the results. You can weigh those results. And then you can make a very careful, deliberate decision.

I mean, you've been a Governor and I haven't. I know there's a different vantage point here and I want to hear that.

Senator GRAHAM. Well, I am a strong supporter of the dual-banking system and continuing to allow two sources of chartering. I'm equally a strong supporter of having the underwriting function be discrete and to provide the insurance regulators—and I strike that phrase because I don't think the insurance people ought to think of themselves as regulators. They ought to think of themselves as underwriters—the insurance underwriters, the capacity to make an independent judgment.

I've just been handed a note which indicates that, in my State, in the decade of the 1970's and the 1980's, that 80 percent of the S&L failures were federally chartered institutions, which says to me that the Federal insurance underwriters shouldn't even accept the Federal charter as in and of itself sufficient to guarantee insurance coverage, that there has to be an independence and a demand for economic stability to qualify for insurance that goes beyond just having at some point in the past being able to secure and maintain a Federal charter.

The CHAIRMAN. Would you say that those are bank failures or thrift failures, or both?

Senator GRAHAM. Thrifts.

The CHAIRMAN. I'd be interested in knowing—you probably don't have it there—I'd be interested in knowing if you—you said 1970's and 1980's. If you were to take it in 5-year segments, so you break each decade into a 5-year period, so you took four 5-year periods over the 1970's and 1980's, the degree to which that would have changed and if you would, say, take the last 5-year period, the degree to which State-chartered institutions would have been a problem moreso than earlier.

Senator GRAHAM. I'm certain that it shifted over the period. One of the reasons is that the total amount of the industry in Federal and State charter also shifted.

In the 1980's, there were many long-time, federally chartered institutions in my State which shifted to become State-chartered.

I don't know if that was a pattern across the country or not. So the whole industry was moving more toward a State-chartered position.

So within that would be a question of what was the relative percentage of each class, Federal versus State, which went into conservatorship in 5-year or annual increments over the last couple of decades?

Mr. RYAN. We can try to prepare that for you. I have one final topic.

The CHAIRMAN. Please. Yes.

Mr. RYAN. You asked me to discuss, which was the topic we're now discussing, which was regulation.

In my multiple roles as FDIC and RTC board member, and director of the OTS, I have been struck by the complexity of the existing financial services regulatory structure. I don't believe that any impartial and objective observer would favor instituting the current system of financial regulation if he was starting from scratch.

As for financial regulatory agency restructuring, I really have no strong opinions as to the proper assignment of regulatory authority.

I do oppose, however, piecemeal reform of the existing financial services regulatory structure. I would prefer comprehensive reform which provides some simplicity to the system.

I would, however, argue strongly against an immediate implementation of significant structural reforms of the Federal regulatory agencies.

If my options were to institute regulatory reform immediately or to defer action until we have finished the clean-up, I would choose to defer action.

If the Government chooses to initiate regulatory restructuring, it should establish a long transition period to ease regulators and the regulated into the changed environment.

I also fully support the separation of the regulatory and insurance function that was initiated under FIRREA specifically for the thrift industry. There is an inherent tension between the roles of regulator and deposit insurer that is inevitable and I believe healthy for the overall safety and soundness of the financial system.

Future role of the industry.

I've been asked to air my views on the future role of the thrift industry. I believe that there will continue to be a dramatic consolidation of the thrift and bank industries over the next few years. Troubled and insolvent S&L's are being removed from the market place through RTC resolutions and other private-sector mergers and acquisitions. This reduction in financial services over capacity may improve the earnings of all financial institutions.

More specific to the thrift industry, there appears to be a viable core of institutions that may be able to continue to operate profitably and maintain adequate capital. Although primarily consisting of thrifts in groups I and II, there is a possibility that even some group III and group IV thrifts can turn it around, if not on their own, then through the process of mergers with healthier financial institutions.

I believe that there is a role in any restructured financial system for well-capitalized, efficient institutions that specialize in housing finance and consumer credit.

I'd like to thank you for the opportunity, and I'm willing to address any additional questions you may have.

[The complete prepared statement of Timothy Ryan follows:]

TESTIMONY OF

TIMOTHY RYAN, DIRECTOR

OFFICE OF THRIFT SUPERVISION

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

UNITED STATES SENATE

September 27, 1990

INTRODUCTION

Thank you, Mr. Chairman, for the opportunity to testify before the Senate Banking, Housing and Urban Affairs Committee on the current condition of the thrift industry.

I have been asked by the Committee to discuss four separate topics: 1) the economic condition of the thrift industry; 2) regulatory measures that have been adopted by the Office of Thrift Supervision to implement FIRREA; 3) my views and recommendations on possible structural changes in future legislation involving depository institutions, including deposit insurance and financial regulation; and 4) the future role of the thrift industry. I will address each of these topics in turn.

I. ECONOMIC CONDITION OF THE INDUSTRY

The economic condition of the thrift industry as well as the banking industry is heavily influenced by prevailing economic trends. Deepening commercial real estate problems, particularly in the Northeast, and continuing sluggishness in the housing sector of the economy, make it an extremely difficult environment for thrift institutions to remain

profitable and well-capitalized. The recent uptick in long-term interest rates may exacerbate the slowdown in the one-to-four family mortgage market.

The second quarter results for the thrift industry reflect the effects of this difficult environment. During the second quarter of 1990, the private sector thrift industry (all savings associations not in the RTC conservatorship program) reported a loss of $196 million. That report, however, represents a continuing moderation of losses for the private sector thrift industry. In the first quarter, private sector thrifts reported a loss of $374 million. In the fourth quarter of 1989, the loss was $3.4 billion and in the second quarter a year ago, the loss was $745 million.

Much of this improvement can be attributed to our program of isolating terminally ill thrifts from the healthy sector of the industry through transfers to the RTC as prescribed by FIRREA. Savings associations subsequently transferred to the RTC accounted for approximately 42% of the first quarter loss, 79% of the fourth quarter 1989 loss, and in the second quarter of 1989, the private sector thrift industry would have been profitable except for the $825 million in losses experienced by associations transferred to the RTC.

To understand the thrift industry, one must look behind the aggregate statistics. There is not one thrift industry, but

several in operation today. The OTS categorizes private sector thrift institutions into four groups according to their financial prospects. Separating the industry into groups based on performance has proved to be an effective tool for the agency to track the financial condition of savings associations.

There were 2,452 private sector thrifts in operation as of June 30, 1990.[1] The thrifts in Group I are the strongest in the industry. They exceed the minimum capital requirements and have been consistently profitable. Group II thrifts meet or are expected to meet existing capital requirements. Group III institutions are troubled with poor earnings and insufficient capital. Group IV institutions are expected to require government assistance as part of their resolution.

Recently, I announced that the deteriorating conditions in the real estate markets was having a negative effect on the

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1.There are some slight alterations to the group numbers that were publicized for the August 1990 group classifications. These alterations reflect structural adjustments occurring between April 1 and June 30, 1990.

These structural adjustments consist of mergers, charter conversions, and RTC resolutions effected between April 1 and June 30, 1990. For example, Group I consisted of 1,175 associations in the August, 1990 classifications based on March 31, 1990 data. After accounting for six second quarter mergers, the new Group I total is 1,169. The 15 RTC thrift resolutions effected in the second quarter have also not yet been rated and placed into the classification system. Finally, there have not yet been any reclassifications between the groups since August 1990 based on the June 30, 1990 data that I am reporting to you today.

capitalization and profitability of the thrifts in those markets. As an example, Group I, the healthiest savings associations, experienced a net decline of 89 institutions between the May and August classifications, mainly due to the effect of troubled real estate assets on savings association portfolios.

On the other hand, however, 34 institutions that were considered prospects for conservatorship earlier in the year have climbed out of Group IV through recapitalization or OTS approval of capital plans that demonstrate a reasonable likelihood that these institutions will be viable.

I would like to make an observation at this point in my testimony. Recently announced higher capital requirements may result in a downward shift in the thrift groupings. The Office of the Comptroller of the Currency has recently announced that it will join the Federal Reserve Board and the Federal Deposit Insurance Corporation in the promulgation of a regulation that adopts a uniform leverage ratio requirement.

The required leverage ratio for the "best" institutions -- those with a CAMEL rating of "1" -- will be 3% core capital. All other financial institutions will be required to have higher leverage ratios of at least 4% with regulators retaining flexibility to establish an even higher leverage

ratio where appropriate.

FIRREA requires that the OTS establish a core capital requirement that is no less stringent than the OCC standard. To comply with this mandate, OTS will review the OCC's new rule and incorporate similar requirements for savings associations through an amendment to its existing capital rule.

OTS has completed some preliminary analyses on the effect of a 4% core capital requirement on the groupings of thrifts. This analysis reveals that the imposition of a 4% core capital requirement on December 31, 1990 for all but the strongest thrifts would throw approximately 100 savings associations with $108 billion dollars in assets out of compliance with minimum capital requirements.

Group I

Now I will review the financial condition of each of the groups of S&L's. As of the end of the second quarter of 1990, Group I, the healthiest, was comprised of 1,169 thrift institutions (48% of the industry) holding $371 billion dollars in assets (35% of the total assets in private sector thrifts). This group earned $646 million in the second quarter of 1990 and has been consistently profitable over the last 4 quarters with net income totaling $2.33 billion

dollars.

Group I is well-capitalized with tangible capital of $24.5 billion, an average tangible capital to assets ratio of 6.57% and a median tangible net worth ratio of 7.9% on a consolidated basis. The group's asset mix is heavily weighted toward one-to-four family mortgages (56% of total group assets) and its liability composition is primarily "core" deposits (68% of total group liabilities). The annualized net interest margin for Group I based on second quarter 1990 data is 2.80%. The group's ROA was 70 basis points compared to 64 basis points for commercial banks as reported by the FDIC.

Group II

Group II contained 674 thrift institutions (27% of the industry) with assets of $352 billion (33% of the assets in the industry). This group earned $31 million in the second quarter of 1990 and earned $494 million in net income for the previous four quarters.

This group has tangible capital totaling $14 billion dollars as of June 30, 1990, a median tangible capital ratio of 5.2% and an average tangible net worth ratio of 3.94%. This group has more non-current assets and real estate owned than Group I and has a lower annualized net interest margin of 2.40%.

The group's second quarter ROA was only 4 basis points reflecting the vulnerability of the group to adverse economic conditions.

Group III

Group III savings associations, those with low earnings and poor capital, represented 350 thrifts (14% of the private sector industry) holding $165 billion dollars in assets (16% of total assets). These institutions had losses of $153 million in the second quarter of 1990 and lost $789 million over the trailing four quarters. Second quarter statistics demonstrate that Group III institutions generated an annualized net interest margin of 2.16% and a ROA of a negative 36 basis points.

Group III institutions also have tangible capital of only $3.6 billion, a median tangible capital ratio of 3.0% and an average tangible capital ratio of 2.16%.

Group IV

Finally, institutions that may require government assisted sales or liquidations reside in Group IV. As of June 30, 1990, there were 244 institutions (10% of the industry) holding $162 billion in assets (15% of total industry assets) in Group IV. Between July 1, 1990 and September 14, 1990,

the OTS transferred 33 of those institutions to the RTC. RTC candidates are concentrated geographically in Texas, Florida and California.

We have found our Group IV classification to be a reliable basis for projecting transfers of savings associations to the RTC. From April 1 to June 30 of this year, we transferred 52 savings associations to the RTC -- 51 of those were from Group IV while only one was from Group III. Between July 1 and September 14, 1990, an additional 33 savings associations were transferred -- all of which were from Group IV. Subtracting those 33 savings associations from our Group IV estimate of 244 institutions that were potential RTC transfers, 211 savings associations remain as government resolution candidates.

Notwithstanding our progress in identifying those severely distressed institutions and isolating them from the healthy portion of the industry, we will find that any further deterioration in economic conditions, especially in the real estate markets, or volatility in the financial markets, may impair the prospects for Group III institutions. At this point in time, we do not expect that those 350 Group III savings associations will require government assistance. Their vulnerability to adverse economic and financial conditions, however, may require that we reclassify them to our Group IV in the future.

II. REGULATORY, SUPERVISORY AND ENFORCEMENT MEASURES IMPLEMENTING FIRREA

Now, I want to turn to a description of our regulatory, supervisory and enforcement initiatives to implement FIRREA.

Capital Regulation

FIRREA required the OTS to adopt new regulations in several important areas. Among the most significant of these new regulations is OTS's capital rule, which sets minimum tangible, leverage, and risk-based capital requirements for savings associations in accordance with the statute.

Earlier this month, I appeared before this Committee on a panel with my colleagues from the other banking regulatory agencies to discuss OTS's capital and accounting standards in some detail. I will not repeat that discussion here. There have been some recent developments regarding capital requirements, however, that do warrant some further discussion.

As I previously mentioned, the Office of the Comptroller of the Currency has announced that it will join the Federal Reserve Board and the Federal Deposit Insurance Corporation

in the adoption of a uniform leverage ratio requirement. OTS is joining the other banking regulatory agencies in adopting the higher leverage ratio standard.

I would like to express my full support for the higher capital leverage ratio requirements. The leverage ratio is an important backstop for the risk-based capital rules, since the risk-based rules do not address some major risks that banks and thrifts face -- principally interest rate and operational risks. Sufficient private capital minimizes potential losses for the federal deposit insurance fund and diminishes the incentives of thrift owners and managers to take excessive risks with insured funds. The imposition of these higher capital requirements is not without consequences, however.

Savings associations were already confronted with an increase in their required risk-based capital ratios from 6.4% to 7.2% on December 31, 1990. Our present capital regulations also contain complicated requirements on the phase-outs of investments in impermissible subsidiaries and supervisory goodwill through December 31, 1994. Meeting the higher risk-based requirements and complying with the phase-outs in conjunction with the new capital leverage ratio standard represents a significant and complex challenge to savings associations.

The practical effect of these changes will be the required submission of capital plans to OTS by many newly undercapitalized thrifts. More savings associations will also be subject to heightened supervisory scrutiny and regulatory constraints on growth, capital distributions, lending and investment authorities and the acceptance of brokered deposits. Many savings institutions will have to shrink and/or retain more of their earnings to meet these capital requirements as well.

Apart from the new leverage ratio requirements, OTS will continue to work toward refining and improving existing capital standards for savings associations. For example, our proposed rule on interest rate risk would improve the standards significantly by requiring thrifts to measure -- and hold capital against -- their interest rate risk exposure.

In addition, OTS has joined with the other financial institutions' regulators to issue, through the Federal Financial Institutions Examination Council (FFIEC), an advance notice of proposed rulemaking soliciting comments on the appropriate treatment of asset sales with recourse for purposes of the risk-based capital rules.

OTS has already incorporated tough capital requirements for recourse transactions into its own risk-based capital rule.

Our goal is to adopt a uniform position on recourse issues as soon as is practically possible.

Adopting Bank Regulatory Standards

One key theme that resounds throughout the FIRREA legislation is that thrift regulation should be comparable to commercial bank regulation. For example, FIRREA applies to thrifts the provisions of the Federal Reserve Act that restrict transactions with affiliates and loans to insiders in the commercial banking sector. In March of this year, OTS issued a proposed rule that would implement some of FIRREA's transactions with affiliates provisions. This regulation will define and clarify the applicability of Sections 23A and 23B of the Federal Reserve Act to thrift institutions. Work on that final rule is now in progress. A proposal that would revise OTS's current rules on loans to insiders is also in development.

FIRREA also required that savings associations be subject to the same limits on lending to one borrower as national banks. Accordingly, OTS has adopted, in final form, a loans to one borrower rule that applies the national bank lending limit -- 15% of unimpaired capital and unimpaired surplus -- to savings associations.

The rule contains a limited transition provision that was

carefully crafted to allow only the best thrifts -- the ones that meet their "fully phased-in" capital standards -- to phase in the new limit over a period that extends through December 31, 1991. Thrifts that qualify under the transition provision may use this lending authority only to finance new projects to develop residential housing or to complete residential or nonresidental projects that were in progress when FIRREA was enacted.

Differential Regulation

The design of the loans to one borrower transition rule reflects a regulatory philosophy that I have described elsewhere as "differential regulation." Briefly, this represents a regulatory approach that recognizes the fundamental differences between healthy and sick thrifts and regulates their activities accordingly.

Another example of this approach is our final rule on capital distributions which took effect on August 1, 1990. This rule ties a thrift's ability to make capital distributions to its capital position and supervisory condition. The healthiest thrifts -- those that meet or exceed their "fully phased-in" capital requirements -- may make capital distributions of up to 50% of surplus capital and 100% of net income. The sick thrifts -- those that do not meet even current minimum capital requirements -- may not make any capital

distributions without prior supervisory approval.

Finally, thrifts in the middle tier -- those that meet or exceed current minimum requirements but are not yet meeting "fully phased-in" requirements-- may make capital distributions in amounts varying from 25% to 75% of net income depending on how near they are to meeting the "fully phased-in" standards.

OTS has also recently completed work on its assessments regulation. This rule implements the mechanism established by FIRREA to fund the regulation and supervision of the thrift industry and is also consistent with the policy of differential regulation. The regulation assesses healthy thrifts at a rate that is 50% lower than the rate for sick thrifts that require more supervisory attention.

The goal of differential regulation is to provide incentives for healthy thrifts to stay that way and for marginal thrifts to achieve financial health as soon as feasible. Conversely, differential regulation ensures that sick thrifts will be subject to the strictest possible supervision until they are ultimately recapitalized or resolved by the RTC.

Uniform Regulations

The policy of differential regulation does not uniformly

apply, however. For example, FIRREA required the OTS and the other financial institutions' regulators to adopt uniform appraisal rules. The content of appraisal rules should not, and does not, vary depending on the financial health of the lending institution. OTS has recently published its final appraisal rule, which established a $50,000 de minimus test -- that is -- real estate transactions of $50,000 or more will require an appraisal by a State certified or licensed appraiser. Our goal was to ensure that most of the home loans made by thrifts would be supported by competent appraisals, and I am pleased to report to you that we achieved that goal.

OTS has also joined with the other banking regulators in issuing a temporary rule implementing FIRREA's amendments to the Community Reinvestment Act. These amendments set new standards for rating the CRA performance of financial institutions and require public disclosure of CRA ratings. We expect to have a final rule in place by year end.

The agency will shortly be sending a proposed regulation over to the Treasury Department which will clarify OTS's position regarding the approval of mutual holding company reorganizations as authorized under FIRREA.

Supervisory Philosophy

The fiscal constraints imposed by FIRREA and other supervisory factors require that we re-examine our supervisory philosophy and restructure our operations to reflect those philosophical changes. I wanted to share some of these changes with the Committee.

First, the challenge that OTS faces is to satisfy the clear need for increased supervisory activity, prompted by both newly emerging and lingering problems, without increasing the cost on the thrift industry to the point of impairing its financial condition. Philosophically and practically, the agency must begin focusing its supervisory planning and resources on the areas of greatest risk. Supervisory and examination processes must be simplified and risk-focused to achieve primary supervisory goals such as identifying and reducing the risks that pose potential costs to taxpayers.

Second, OTS has concluded that the examinations process is our most important supervisory tool. There must be a redeployment of agency staff resources toward that function. The agency restructuring process discussed below is, among other things, designed to increase the number of examiners and improve the ratio of examination personnel to total agency staff. The examination process clearly represents the best method of redirecting supervisory efforts toward items of the greatest risk to the safety and soundness of the system.

Third, an increase in the number of examiners is critical in order to achieve our ambitious goals for increased frequency of examinations. Presently, the Office of Thrift Supervision presently has a ratio of 2.2 institutions per examiner. This is compares favorably to the OCC's ratio of 2 institutions per examiner. I am committed to improving that ratio in the near-term.

This will enable OTS to enhance its existing examination schedule so that the following savings associations are examined annually:

- Over $1 billion in assets (189 savings associations);
- Over $500 million in assets operating under approved capital plans (52 savings associations); or
- Rated MACRO 3, 4, or 5 (957 savings associations).

The total number of savings associations contained in at least one of these categories and, thus, subject to an annual examination is 1047. All other savings associations rated MACRO 1 or 2 that are under $1 billion in assets would be examined at least every 18 months.

Agency Restructuring

To meet these supervisory goals, OTS must increase and

improve the efficiency of its internal operations. We have recently taken significant steps toward meeting that goal. We have announced a restructuring plan that consolidates the agency into five regional offices (overseeing a total of seven district offices) and a Washington headquarters.

This new, decentralized regulatory structure will result in some major improvements. First, the consolidation of administrative and support functions will eliminate redundancies and reduce costs. These cost reductions combined with other cost savings measures will allow us to lower our assessments in future quarters.

Second, the regionalization plan will facilitate the consistent application of operating and regulatory policies and standards nationwide and will result in the efficient, streamlined and risk-focused deployment of our supervisory resources that is critical to achieving our supervisory goals.

In order to complement our restructuring effort, a tandem project is now under way to delegate to field staff additional responsibilities for the review and approval of certain applications that now come to Washington. Washington headquarters will continue to ensure consistently in our regulatory program by setting nationwide policies and standards. In our judgment, however, the implementation of

those policies is a function that should be delegated to the field.

This regionalization of functions will promote decision-making by examiners and supervisory personnel who are the most knowledgeable about the safety and soundness of savings associations in their district or region. Because they conduct the examination and day-to-day oversight of these institutions, these staff are generally in the best position to make decisions about the institutions they supervise.

Enforcement Philosophy

FIRREA also greatly expanded the agency's enforcement powers and authorities. One of my top priorities when I took office six months ago was to make sure that OTS had a vigorous enforcement program that would rid the thrift industry of wrongdoers and compel them to return their ill-gotten gains to the public. We have made several important strides in pursuit of that goal.

Before discussing specific enforcement initiatives, I would like to briefly share my enforcement philosophy with you. It is clear that the directors, officers, and agents of a financial institution, such as attorneys, accountants and other professionals, owe a fiduciary duty to the

institution's owners. In our view, their duty also extends beyond that. These insiders owe a fiduciary duty to the government because it is the government that will ultimately bear the losses resulting from excessive risk-taking. This duty means that directors, officers, and other fiduciaries should not -- may not -- countenance activities that threaten the institution's financial health.

The possibility that the owners and managers of troubled or failed savings associations may avoid the full effects of justice by transferring or concealing their assets is one of the difficulties that we have faced. To put an end to such evasive action, we have begun to ask courts to freeze the assets or to require an accounting of those who are the subject of an enforcement proceeding.

We recently made these requests in regard to Mr. Tom Spiegel, formerly of Columbia Savings, and Mr. Charles Keating, formerly of Lincoln Savings and Loan. Our purpose is to ensure that the assets will be available at the end of a proceeding so that an order requiring that money be returned to the public will have full effect. We intend to take such action whenever our enforcement attorneys can make out a prima facie case of wrongdoing and we have reason to believe that the respondent currently has substantial assets.

To give the asset freeze policy the effect of statute, both

the Senate and the House versions of the crime bill contain provisions to incorporate this policy. We urge the House and Senate conference committee to adopt this asset freeze policy.

We have also begun to increase our enforcement resources. We have determined that the use of outside counsel is not cost effective, and we have now discontinued their use in all litigation and enforcement matters. In their place, we have attracted several litigators and enforcement attorneys to supplement the energetic and hard-working staff that was at OTS when I arrived. In addition, we have created places for three regional directors of enforcement so that we can spot problems in the field more quickly and move promptly when action is required.

The effectiveness of OTS's enforcement actions is predicated on close cooperation with the Justice Department, which is able to bring criminal prosecutions. We are working well and closely with the Justice Department and recently provided them with a list of the top 100 criminal referrals. In the past two years, approximately 328 indictments have come down and 231 savings and loan defendants have been convicted. There are 654 pending investigations as well. We understand that grand juries have already indicted 79 defendants from 47 different institutions on the top 100 list. Investigations are ongoing with respect to many of these institutions.

OTS also will open many enforcement matters to the public record. In July, we announced that administrative hearings on enforcement actions involving closed or RTC-operated thrift institutions will be open to the public, barring a compelling reason for confidentiality. These open hearings will set a valuable precedent for bank and thrift enforcement cases and serve to reassure the public that we as regulators are doing everything possible to ensure the integrity of thrift institutions and the protection of the taxpayer.

In conclusion, OTS's enforcement efforts will continue to be aggressive. We intend to make the fullest possible use of our authority to hold wrongdoers publicly accountable for their conduct, whether those wrongdoers are the owners or managers of the institution or the professionals on whom they have relied. We will continue to fulfill our responsibility to articulate as clearly as we can the standards of conduct that bind directors, officers, and their professional advisors.

III. STRUCTURAL CHANGES

The Committee has asked me to express my views on any structural changes that I think Congress should consider in the future, including modifications to the deposit insurance system or financial regulation.

I would like to make a couple of key points before I discuss my recommendations for structural changes. First, I do not want my testimony today in any way to prejudge or anticipate the comprehensive Treasury Department study on deposit insurance and financial services regulation currently under development that the Committee will be receiving later this year or early next year. My views will be encompassed in that study, and any recommendations that I make today for that reason are preliminary. The recommendations and conclusions contained in the Treasury study should serve as a blueprint for action on these complex issues during the 1990's.

Second, I would like to express my strong support for structural changes that have already emerged from FIRREA, particularly tough capital and accounting standards and new enforcement powers. I believe that the implementation of these changes over the past year by the OTS has already begun to mitigate some of the risks and the "moral hazard" problem inherent in federal deposit insurance.

Deposit Insurance

Some analysts believe that one of the root causes of the thrift crisis was the federal deposit insurance system, both in its availability to all thrifts without limit,

particularly with a "too big to fail" policy effectively insuring all deposits in larger financial institutions, and the flat-rate pricing of insurance premiums regardless of a particular institution's risk profile.

There is no shortage of prescriptions to reform the federal deposit insurance system. Congress has recently heard recommendations from Chairman Seidman and Chairman Greenspan outlining their preferred approaches to reforming the deposit insurance system.

On July 31, 1990, Mr. Seidman testified before this Committee that financial reforms should have three objectives: reducing the potential liability of the government as insurer, maintaining the stability of the financial system and increasing the competitiveness of American banks. He suggested a limitation on deposit insurance of $100,000 per account holder and implied that the notion that some banks are "too big to fail" should be re-examined and restricted. He also expressed his opposition to using federally insured deposits for risky lending and investment activities and recommended that these activities be conducted in separately capitalized affiliates within a holding company structure.

Chairman Greenspan recently stated that the "safety net" of deposit insurance has distorted market signals to depositors and bankers resulting in a lack of depositor caution in

choosing depository institutions and an increase in excessive risk-taking by owners and managers of financial institutions.

He discussed a variety of options for deposit insurance reform such as co-insurance or private deposit insurance supplementing the government insurance fund, risk-based insurance premiums, and the "narrow bank" concept, among others, and deemed them worthy of review by the Congress, but affirmed his primary support for higher capital requirements and prompt corrective action by supervisory agencies to eliminate risk-taking and preserve the insurance fund.

Both you, Chairman Riegle, and Chairman Gonzalez have recently announced your own plans for appropriate reform of the federal deposit insurance system. Some of your and Chairman Gonzalez's suggested reforms include increasing existing ceilings on deposit insurance premiums to shore up the FDIC fund, limiting the policy of "too big to fail", charging premiums on foreign deposits and other borrowings, implementing "risk-based" insurance premiums reflecting differences in portfolio risks among federally insured institutions and requiring stringent supervisory action against troubled institutions.

I support in principle any government efforts that would shift more of the risk of losses in financial institution operations away from the government -- and ultimately the

taxpayers -- and placing more of that risk with the shareholders and debtholders of insured financial institutions where it appropriately belongs.

I also support the Administration's draft legislation entitled the "Deposit Insurance Funds Flexibility Act of 1990" which provides the FDIC with significantly greater flexibility to set assessment and rebate levels for insured institutions. In particular, it would remove arbitrary statutory constraints that establish limits on annual and overall assessment rates while still requiring the FDIC to factor in the effect of rate increase on the earnings and capitalization of insured institutions.

I have fundamental concerns about the concept of "too big to fail" that, in effect, insures all depositors in large financial institutions. This is a difficult issue for the regulatory agencies and the Congress to address. Basic issues of fairness argue against the protection of uninsured depositors and debtholders in large institutions, but not smaller associations. On the other hand, Chairman Greenspan articulates a persuasive position that perhaps the failure of some very large banks may, at a particular time, be so disruptive to the financial system that the government must make an exception.

I am also concerned about the ramifications of lowering the

$100,000 limit for deposit insurance. There are transition costs and funding disruptions inherent in imposing a lower level of deposit insurance coverage on the existing system that may outweigh the benefits of decreased government exposure to losses. I do, however, believe that a Congressional review of the existing coverage of multiple accounts up to $100,000 for individual depositors is prudent.

There are some aspects of deposit insurance reform that we in the regulatory community can consider and perhaps implement. These are not the "big picture" issues but, rather, issues arising from the administration and interpretation of the statutes that currently govern deposit insurance.

An example of such an issue is whether private pension plans should be afforded pass-through insurance treatment. Pass-through coverage means that the interest of each plan participant is insured separately, up to $100,000 per participant. Under current FDIC rules, pass-through coverage applies to private plans.

Chairman Gonzalez has taken the position that large accounts placed by professional investors, such as private pension plan accounts, should not be insured on a pass-through basis. His package of reform proposals would limit the deposit insurance available on such accounts.

I fully agree that the proliferation of deposit insurance is an issue that should be studied seriously, and I am personally inclined toward a cautious approach. We at the FDIC may even be able to implement some reform without the need for statutory change.

In a rule adopted by the Board of Directors on April 30 of this year, for example, the FDIC declined to give pass-through treatment to the so-called "457 plans," that is, unfunded, deferred compensation plans maintained by state and local governments pursuant to section 457 of the Internal Revenue Code. In light of this decision, I believe we should revisit the issue of whether pass-through coverage should apply to private plans. Moreover, I believe we can and should address more limited issues, such as this one, while debate is proceeding on comprehensive reform.

In conclusion, the climate in the financial services industry is too volatile, risky and competitive, and the insurance fund's financial condition too precarious, to allow the regulatory system to remain unchanged. The OTS is committed to the creation of a regulatory environment that includes the adoption and implementation of higher capital standards, an enhancement of the timeliness and proficiency of the regulatory monitoring and examination process and the implementation of a meaningful approach to closing institutions that will either close, or severely constrain

the operations of savings associations, as they approach insolvency in order to minimize the financial risks to the deposit insurance fund.

These supervisory and examination policies will complement any deposit insurance reform measures deemed appropriate by Congress and decrease the existing threat to the integrity of the FDIC fund.

QTL Test/Insurance Premiums

The Qualified Thrift Lender test that takes effect on July 1, 1991 significantly narrows the range of activities that a thrift may engage in vis a vis a commercial bank. While consistent with the philosophy of maintaining a separate thrift industry devoted almost exclusively to housing, it has the disadvantage of more strongly linking thrift performance almost exclusively to cyclical housing markets. This makes the thrift industry more vulnerable to downturns than banks that have more diversified asset and lending powers.

It is not yet possible to judge the full impact of the new QTL test on savings associations and it will not be possible until the test is fully phased-in on July 1, 1991. The test limits asset diversification options, yet it appears that the majority of our healthy institutions meet the requirements of the test, so it is too early to recommend sweeping changes to

the test.

I would, however, recommend that Congress consider one substantive amendment to FIRREA that would modify the QTL test. The new QTL test will limit the percentage of liquid assets eligible to be considered "qualified thrift investments" in order to meet the test. Many savings associations, particularly in an unstable economic environment, may prefer to hold a higher percentage of their assets in highly liquid assets to be able to respond quickly to marketplace changes. The new QTL test limits that flexibility. Thus, OTS recommends amending the test in order to allow a thrift to increase the amount of liquid assets that can count toward meeting the new test from 10% to 20%. We may have further recommendations in the future to help minimize the administrative complexity of the test.

I also personally recommend eliminating the disparity in deposit insurance premiums between thrift institutions and banks in order to ensure that thrifts and banks are equal in their competitive capabilities in the marketplace.

Federal Home Loan Bank System

It is important that the savings and loan industry help contribute to the cost of the industry cleanup. Under FIRREA, thrifts make this contribution through their

membership in the Federal Home Loan Bank System and through significant deposit insurance premiums.

The effect of the restructuring of the industry, and the resultant loss of membership due to the declining number of viable savings associations, is leading to a decline in the System's earnings and is contributing to an erosion in its capital base. This is in turn lowering the dividend income that thrift institutions are receiving from the FHLBanks and impairing their financial condition.

The deteriorating financial and operational situation for the FHLBanks has led some savings institutions with a statutory responsibility to help fund the resolution of the S&L crises to attempt to "opt out" of the system by which the funding of the savings and loan problem is accomplished. During my tenure at OTS, at least eight savings associations have applied to withdraw from membership in their Federal Home Loan Banks while retaining federal deposit insurance.

OTS has concluded that all institutions holding SAIF-insured deposits are legally obligated to maintain their Bank membership. Moreover, withdrawal from membership would raise serious safety and soundness concerns related to an institution's ability to conduct effective interest rate risk and liquidity management.

Even beyond those concerns, however, is the larger question of the effect that departures from the Bank System would have on the Banks' ability to fund the REFCORP and contribute to FIRREA's Affordable Housing Program to the extent envisioned by FIRREA.

If Congress determines that membership in the Federal Home Loan Bank System should be mandatory for all savings associations, regardless of charter, it should also review appropriate methods of ensuring the long-term health of the Federal Home Loan Bank System for the sake of the thrift industry cleanup and the ongoing viability of the remaining private sector thrift industry.

Savings Bank Charter "Flips"

When I appeared before this Committee in June of this year, you, Mr. Chairman, expressed outrage regarding the disproportionate amount of losses to the insurance fund that occurred due to the activities of state-chartered thrift institutions in states such as Texas, California and Florida that allowed significant deregulation. We provided you with statistics that demonstrated that in 1988, 1989 and early 1990, for example, the FSLIC and RTC resolution costs for state-chartered thrift institutions in these three states alone were 74%, 70% and 57% of the total resolution costs, respectively. You called these powerful numbers and I agreed

with you.

Now, I am greatly concerned because there is a movement afoot in a number of states to pass legislation creating a savings bank charter that could allow many institutions that we know today as "savings associations" to escape many of the FIRREA reforms. In Illinois, for instance, the Governor has recently signed the "Illinois State Chartered Savings Bank Act."

We oppose this legislation -- and similar legislation in other states -- because it would give Illinois-chartered savings banks broader authorities than savings associations have in key areas including the qualified thrift lender test, the scope of permissible investments, the applicable limits on junk bond holdings, and the limits on commercial real estate lending. We believe that the savings bank legislation creates a mechanism for depository institutions that were clearly within the purview of the Congress's FIRREA reforms to escape the reach of those reforms by operating under a different kind of charter.

When it addresses structural reform, Congress should consider the extent to which states should be permitted to create parallel systems of depository institution regulation that undermine reforms undertaken at the federal level. I believe this issue is embedded in FIRREA in the sense that FIRREA

"grandfathers" certain pre-existing savings bank powers.

This grandfathering may lead some states to conclude that the Congress has sanctioned alternative regulatory limits on savings associations so long as the alternative is achieved through the mechanism of a savings bank charter. Accordingly, the Congress may wish to revisit the issue of whether grandfathering of this type is appropriate when it considers the relationship between the state and federal systems.

Separation of Banking and Commerce

In his recent testimony, Chairman Seidman urged Congress to remove Bank Holding Company Act restrictions that prevent commercial banks from affiliating with nonfinancial businesses. The Savings and Loan Holding Company Act has no such restrictions. This flexibility has permitted a number of well-known industrial and commercial companies, as well as diversified financial services firms to own thrifts.

OTS's experience with commercial and industrial company ownership of S&L's does not indicate that the diversified types of activities conducted by such holding companies are uniquely problematic or have had any detrimental effects on those companies' subsidiary thrifts. In fact, at times, the financial resources of parent industrial and commercial

companies has been a key source of additional capital for their subsidiary thrifts.

Transactions with affiliates restrictions and the OTS's capital distributions regulation limiting dividend payments act as substantial safeguards against holding companies diverting the resources of their subsidiary S&L's. Congress should review the necessity of maintaining the separation between banking and commerce in light of the OTS experience that ownership of thrifts by commercial and industrial firms has, on balance, been a positive factor in the safety and soundness of the thrift industry.

Financial Regulation

The Committee has asked me to express my views regarding structural changes to financial regulation. I would recommend the following basic principles for the Committee to consider in its efforts to modernize financial services regulation.

In my roles as FDIC and RTC Board member and Director of OTS, I have been struck by the complexity of the existing financial services regulatory structure. Five different federal regulatory agencies and a plethora of state regulators make it extremely difficult to take concerted action to address the supervisory problems of troubled

financial institutions. I don't believe that any impartial and objective observer would favor instituting the current system of financial regulation if he was starting from scratch.

As to financial regulatory agency restructuring, I hold no strong opinions as to the proper assignment of regulatory authority. I do, however, oppose any "piecemeal" reform of the existing financial services regulatory structure. My general philosophy is that there should be fewer agencies than presently exist. Comprehensive and rational reform is preferable to legislative measures that do not address the complex interrelationship between federal deposit insurance, existing and new investment authorities for financial institutions to compete in the global marketplace, and regulatory restructuring.

Having expressed this view, I would, however, argue strongly against an immediate implementation of significant structural reforms of the financial regulatory agencies. If my options were to institute regulatory reform immediately or to defer action until the end of the "crisis", I would choose to defer action. The persistent regulatory and legislative turmoil that has occurred since even before the passage of FIRREA has already been counterproductive to dealing with many failed and failing savings associations.

A period of relative regulatory and legislative stability is absolutely essential to see us through this tumultuous period. It is imperative that the regulatory agencies be exposed to minimum levels of disruption and confusion during this period of RTC resolutions of failed thrifts and disposition of assets. The financial pressures on many banks, and the FDIC insurance fund, also argues against the adoption of a near-term regulatory restructuring. If Congress chooses to initiate restructuring legislation, it should ensure a long transition period to ease regulators and the regulated into the changed environment.

I also fully support the separation of the regulatory and the insurance function that was initiated under FIRREA, specifically for the thrift industry. There is an inherent tension between the roles of regulator and deposit insurer that is inevitable and, I believe, healthy for the overall safety and soundness of the financial system.

IV. FUTURE ROLE OF THE INDUSTRY

Finally, I have been asked to air my views on the future role of the thrift industry. I was asked this question during my confirmation hearings and, given my limited experience with the industry, I declined to speculate about its future. Now, after six months in office, I am prepared to offer some very preliminary thoughts.

The future role of the thrift industry in the financial serevices marketplace will be determined by macroeconomic factors totally independent from any regulatory and supervisory activities undertaken by OTS. OTS will be playing no role as the "chief architect" of the future of the thrift industry. That role would be entirely inappropriate, even if it was available to us.

I believe that there will be a dramatic consolidation of the thrift industry over the next few years. Troubled and insolvent associations are being removed from the marketplace through RTC resolution activity and other private sector mergers and acquisitions. There will also likely be increased merger and acquisition activity among healthy savings associations and between banks and thrifts to reap the benefits of geographic diversification, economies of scale and increased market share.

This reduction in financial services overcapacity may improve the earnings of all financial institutions during the late 1990's by lowering the deposit costs of the surviving institutions and widening the spreads on mortgage loans as financial institution competitors that are insolvent or troubled are removed from the marketplace.

More specific to the thrift industry, there appears to be a

"viable core" of associations that may be able to continue to operate profitably and maintain adequate capital. Although primarily consisting of thrifts in Groups I and II, there is a possibility that even some Group III or IV thrifts can turn it around, if not on their own, then through the process of mergers with, or acquisitions by, healthier financial institutions.

I believe that there is a role in any restructured financial system for well-capitalized efficient institutions, both national and community-based, that specialize in housing finance and consumer credit. There are presently many thrift institutions still in operation that have proved, and may continue to prove, themselves capable of effectively fulfilling that role in the long term.

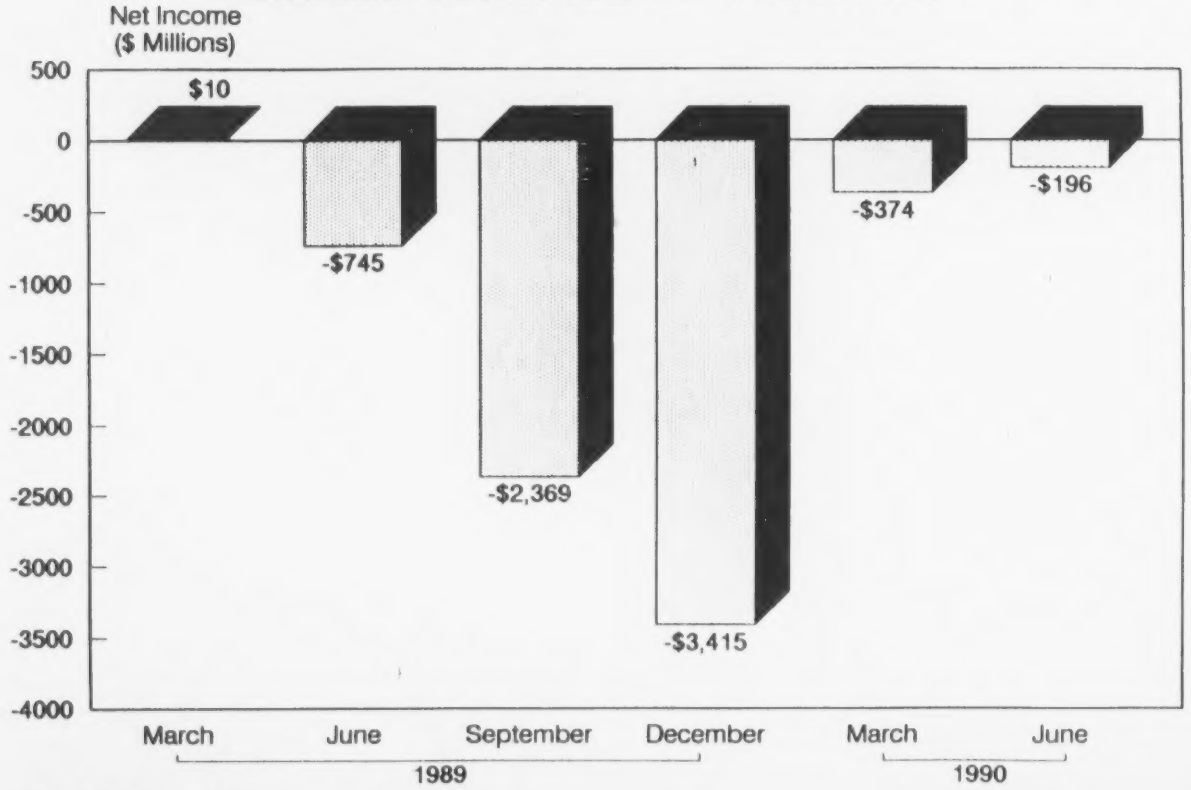
Thank you for the opportunity to offer my views on the current condition of the thrift industry. I would be happy to address any questions that you may have.

2ND QUARTER FINANCIAL DEVELOPMENTS FOR PRIVATE SECTOR THRIFTS

September 24, 1990

141

PRIVATE SECTOR THRIFT INDUSTRY LOSSES CONTINUE TO MODERATE

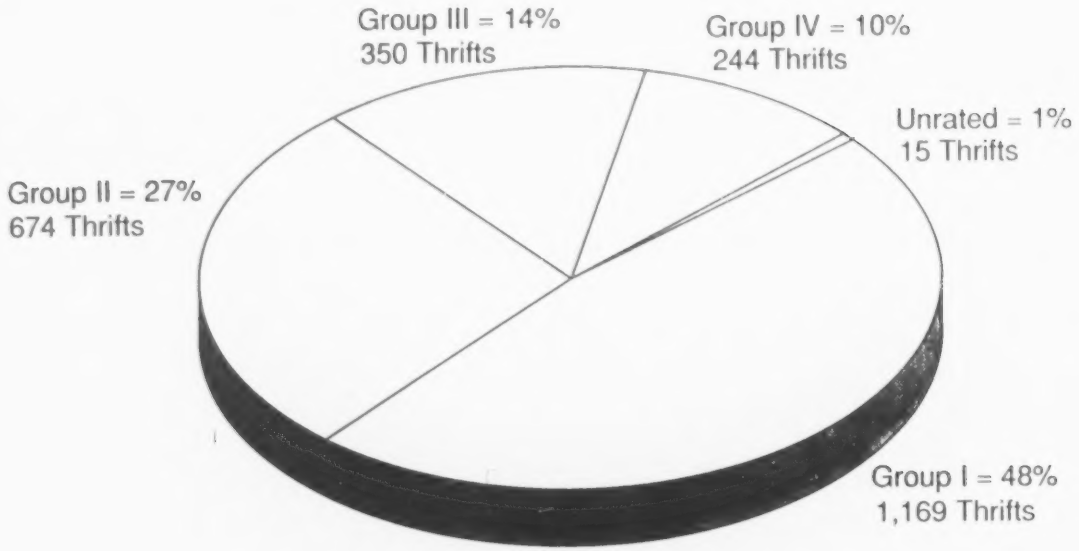


Office of Thrift Supervision

OTS CLASSIFICATION OF PRIVATE SECTOR THRIFTS

- GROUP I - Well capitalized and profitable
- GROUP II - Meet or expected to meet capital requirements
- GROUP III - Troubled with poor earnings and low capital
- GROUP IV - Expected transfers to the RTC

Number of Private Sector Thrifts

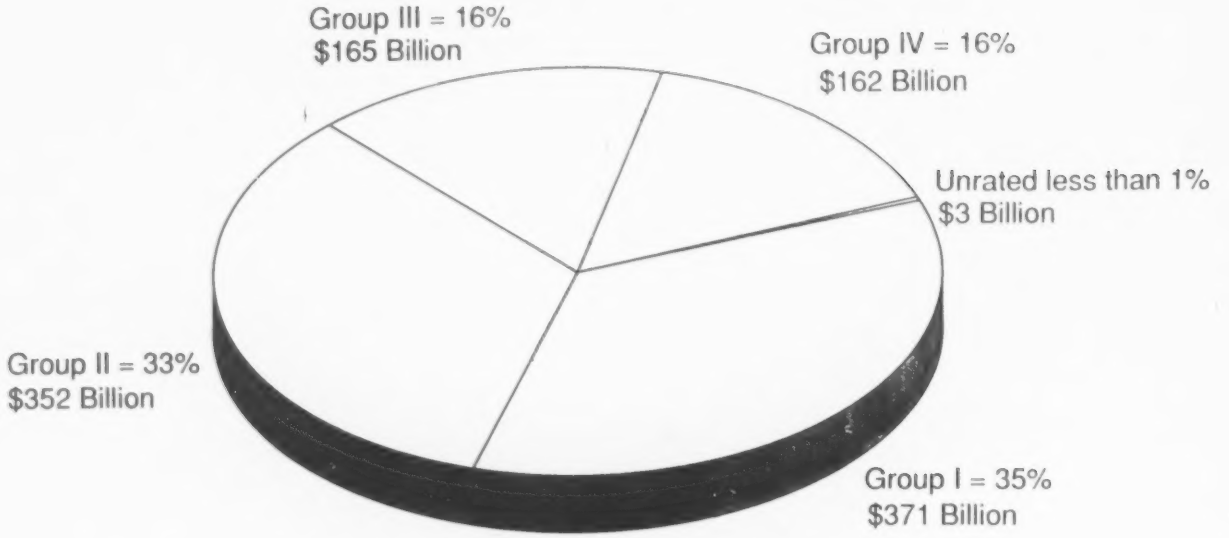


Thrifts = 2,452

Presentation based on August classifications.

Office of Thrift Supervision

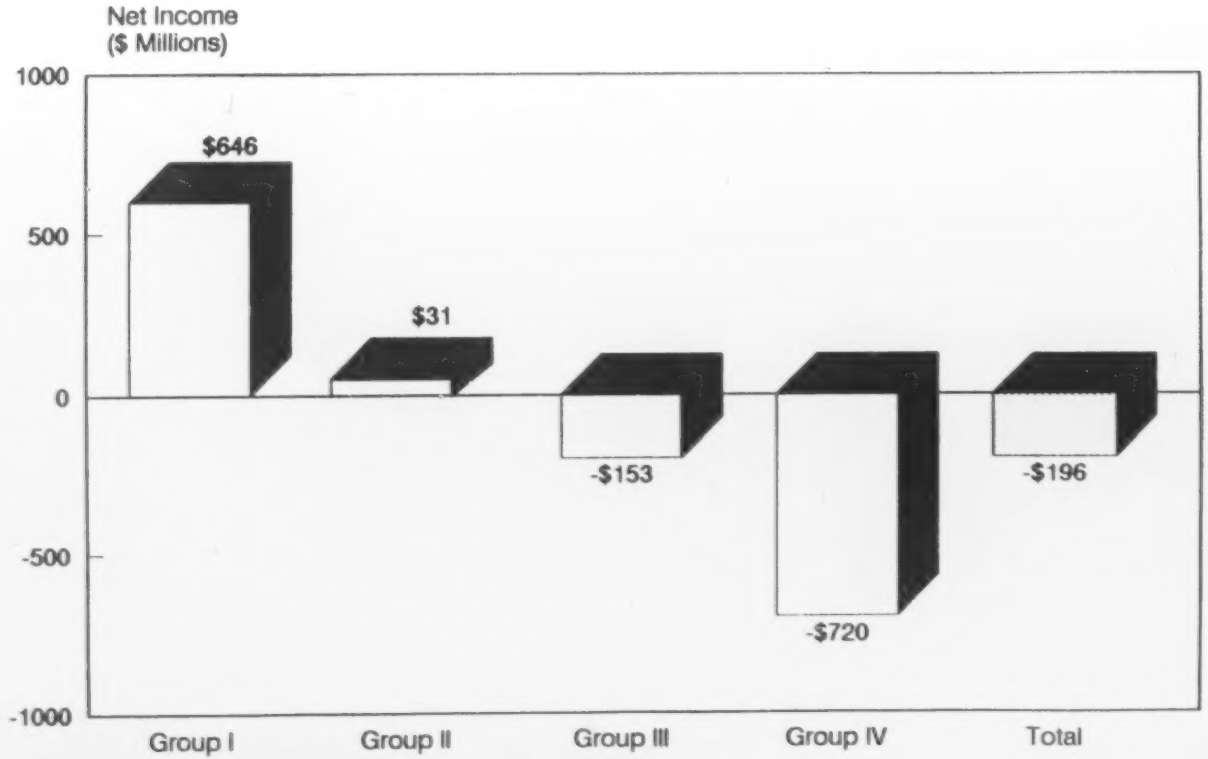
Assets of Private Sector Thrifts



$1,053 Billion in Assets

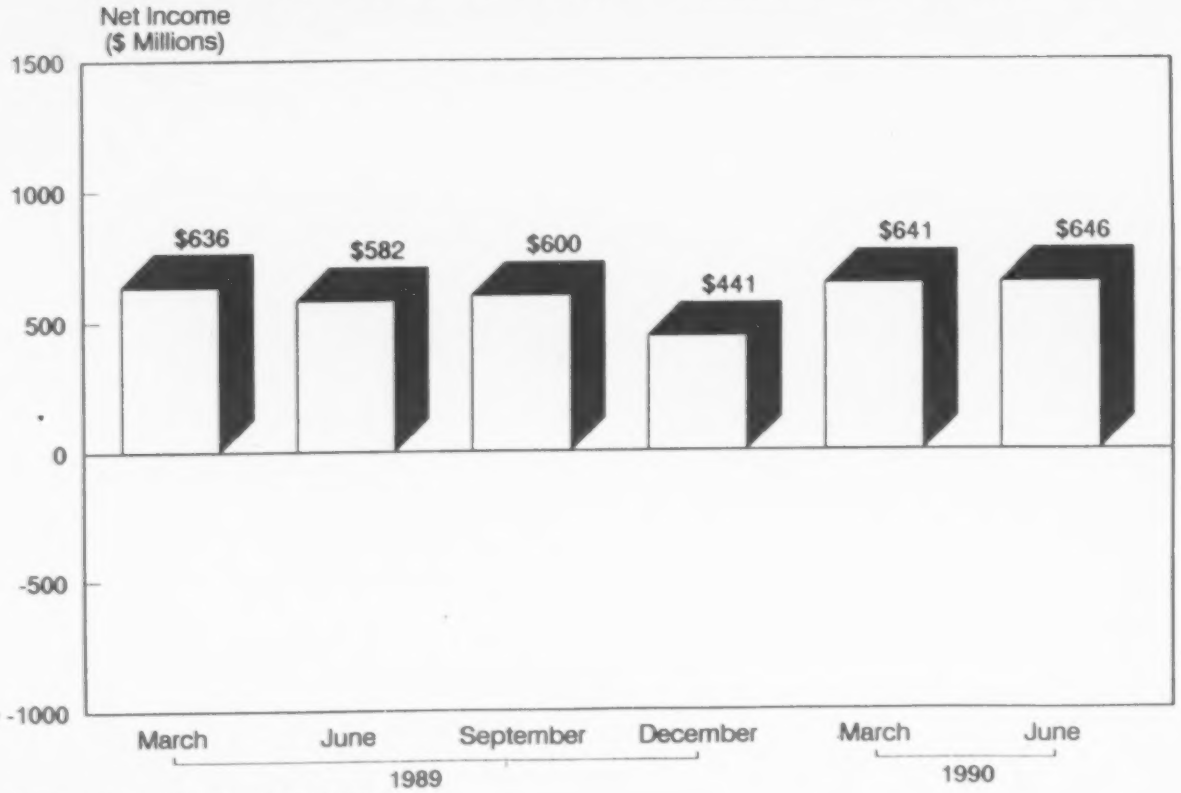
Presentation based on August classifications and June 1990 financial data.
Office of Thrift Supervision

PROFITABILITY VARIES WIDELY



Presentation based on August classifications and June 1990 financial data.
Office of Thrift Supervision

GROUP I THRIFTS ARE CONSISTENTLY PROFITABLE



Presentation based on August classifications
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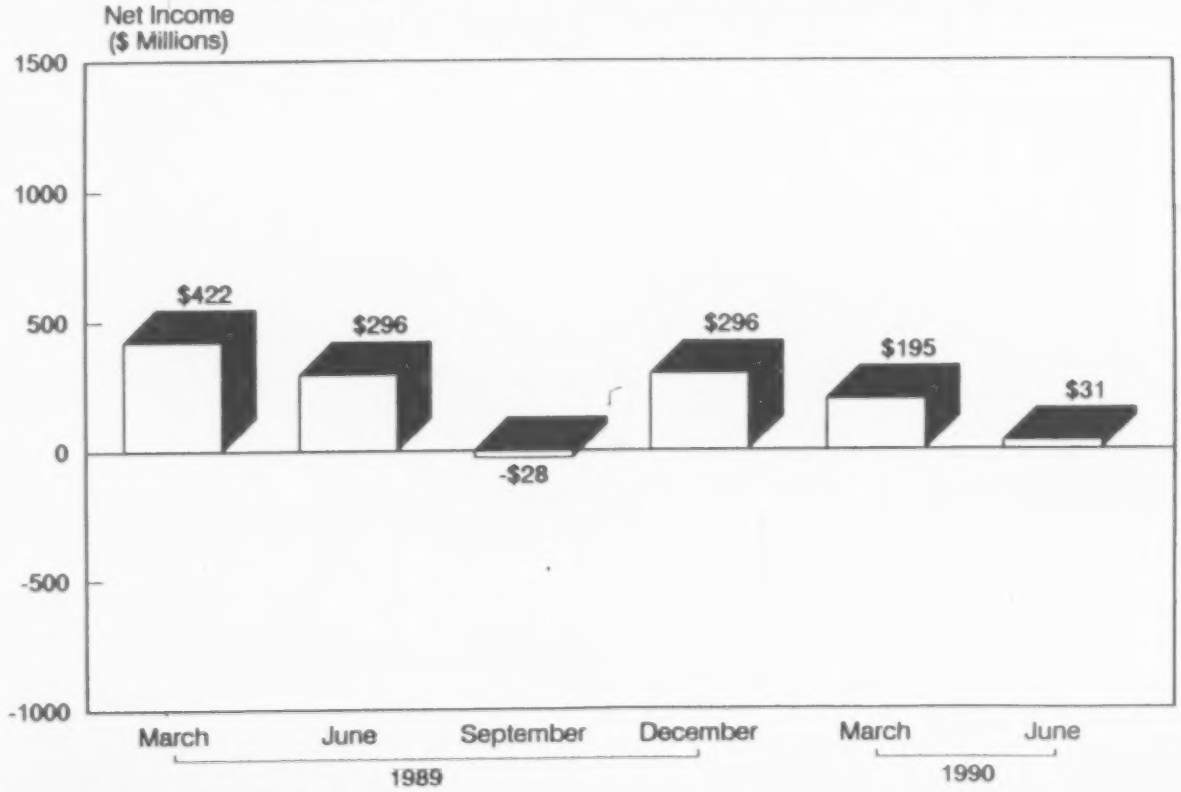
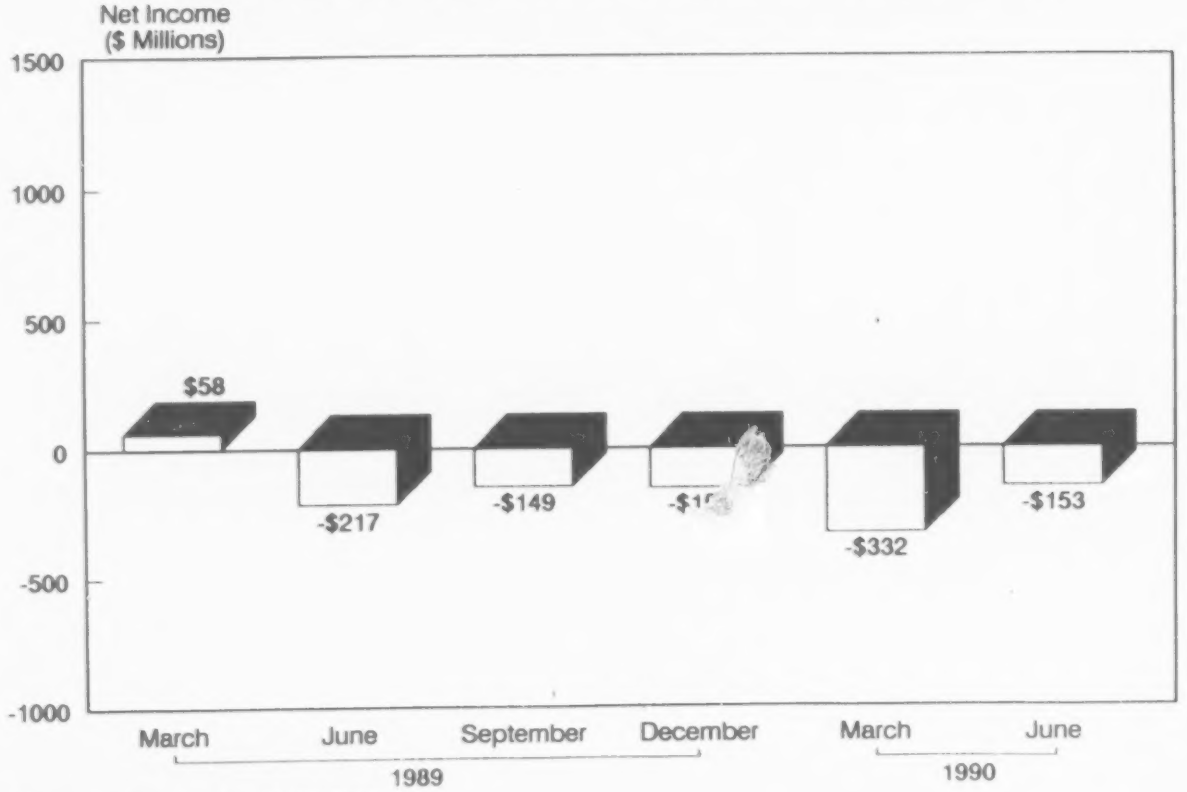
GROUP II THRIFTS EARNINGS HAVE DECREASED



Presentation based on August classifications.
Office of Thrift Supervision

GROUP III THRIFTS SHOW CONTINUING LOSSES



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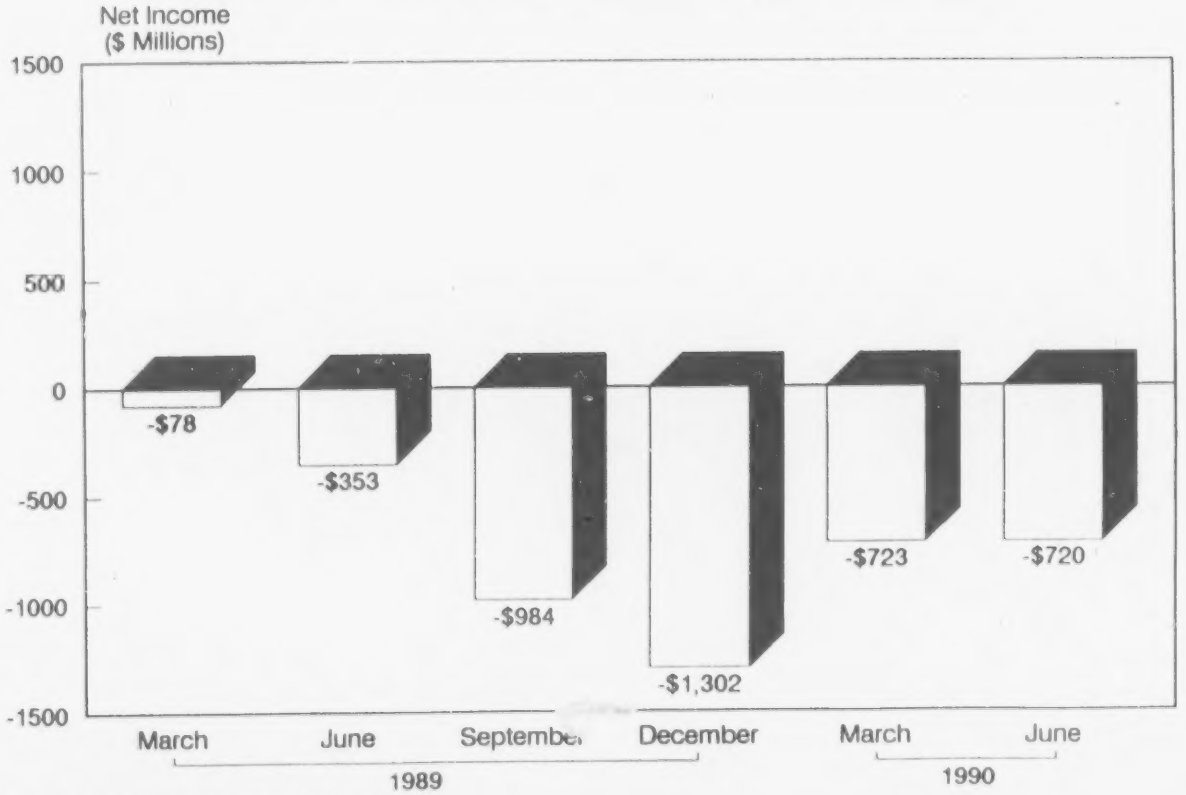
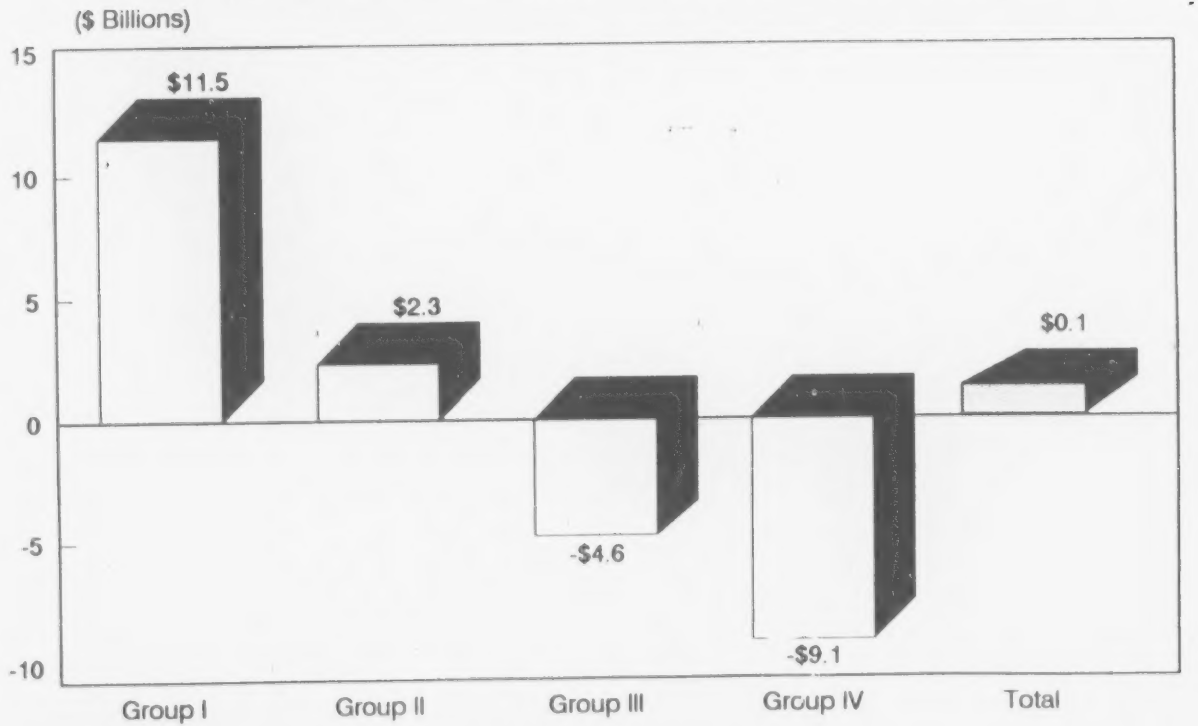
GROUP IV THRIFTS REMAIN UNPROFITABLE



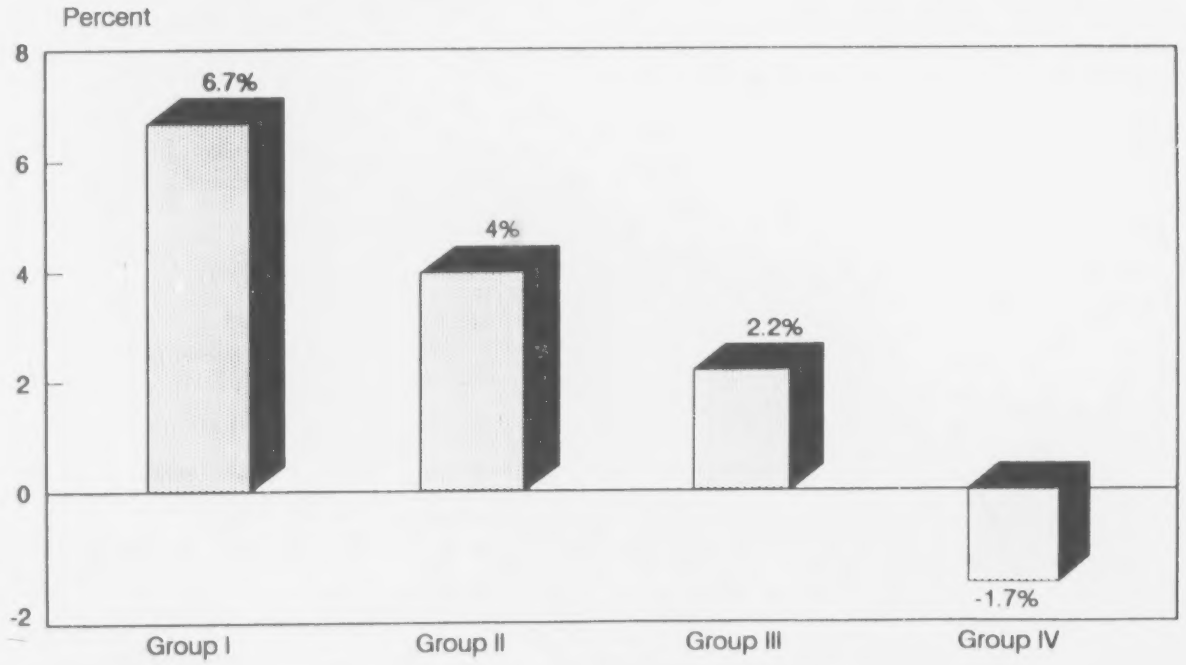
Presentation based on August classifications.
Office of Thrift Supervision

DEPOSITS AT PRIVATE SECTOR THRIFTS HAVE GROWN SLIGHTLY OVER THE PAST YEAR



Presentation based on August classifications and financial data through June 1990.
Office of Thrift Supervision

AVERAGE TANGIBLE CAPITAL TO ASSET RATIO BY GROUP



Presentation based on August classifications and June 1990 financial data.
Office of Thrift Supervision

SUMMARY: VARIETY OF CONDITIONS AMONG SAVINGS ASSOCIATIONS

(Financial Data as of June 30, 1990)

	Number of Institutions	Assets ($ Billions)	Percent of Private Sector Industry Assets	Net Income for 2nd Quarter ($ Millions)	Median TNW (% Of Assets)
GROUP I	1,169	$371	35%	$646	7.9%
GROUP II	674	$352	33%	$31	5.2%
GROUP III	350	$165	16%	-$153	3.0%
GROUP IV	244	$162	15%	-$720	-0.1%

Data excludes 15 unrated new entrants representing 1% of total institutions and $3 billion in industry assets.
Office of Thrift Supervision

MEMORANDUM

To: Senator Garn

From: Republican Comittee Staff

Date: September 27, 1990

Subject: Comparison of State-Chartered v. Federal-Chartered Thrift Failure Resolution Costs

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The Office of Thrift Supervision recently released charts illustrating the FSLIC and RTC Resolution Costs for State and Federally-chartered thrifts for the years 1982-1990. An analysis of this data on a year-by-year basis and on a cumulative basis indicates that State-chartered institutions accounted for the overwhelming majority of losses.

CUMULATIVE RESOLUTION COSTS

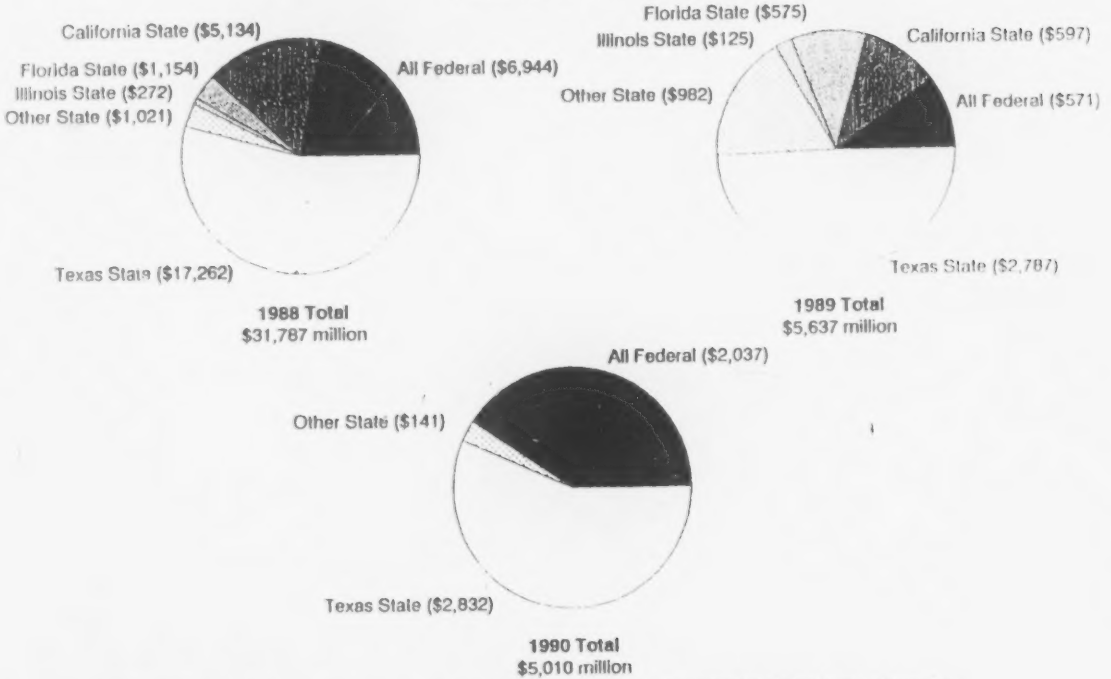
	1982-90	1985-90	1987-90
State Thrifts:	**74%**	**74%**	**77%**
Federal Thrifts:	26%	26%	23%

ANNUAL THRIFT INDUSTRY RESOLUTION COSTS

	1990	**1989**	**1988**	**1987**	**1986**	**1985**	**1984**	**1983**	**1982**
By Percentage of Total Cost:									
State:	**59%**	**90%**	**78%**	**67%**	**50%**	**43%**	**72%**	**69%**	**38%**
Federal:	41%	10%	22%	33%	50%	57%	28%	31%	62%
In Billions of Dollars:									
State:	**$3.0**	**$5.1**	**$24.8**	**$2.5**	**$1.5**	**$0.4**	**$0.5**	**$0.2**	**$0.3**
Federal:	$2.0	$0.6	$ 6.9	$1.2	$1.5	$0.6	$0.2	$0.1	$0.5
Total Losses:	$5.0	$5.6	$31.8	$3.7	$3.1	$1.0	$0.7	$0.3	$0.8

FSLIC and RTC Resolution Costs for State-Chartered Institutions in Selected States*

(1982-1990, $ millions)



*Selected states include Texas, California, Florida, and Illinois. If one of the selected states is not shown for a particular year, there were no costly resolutions that year among that state's state-chartered institutions.

RTC/Office of the Chief Economist/sjp

FSLIC and RTC Resolution Costs for State-Chartered Institutions in Selected States*

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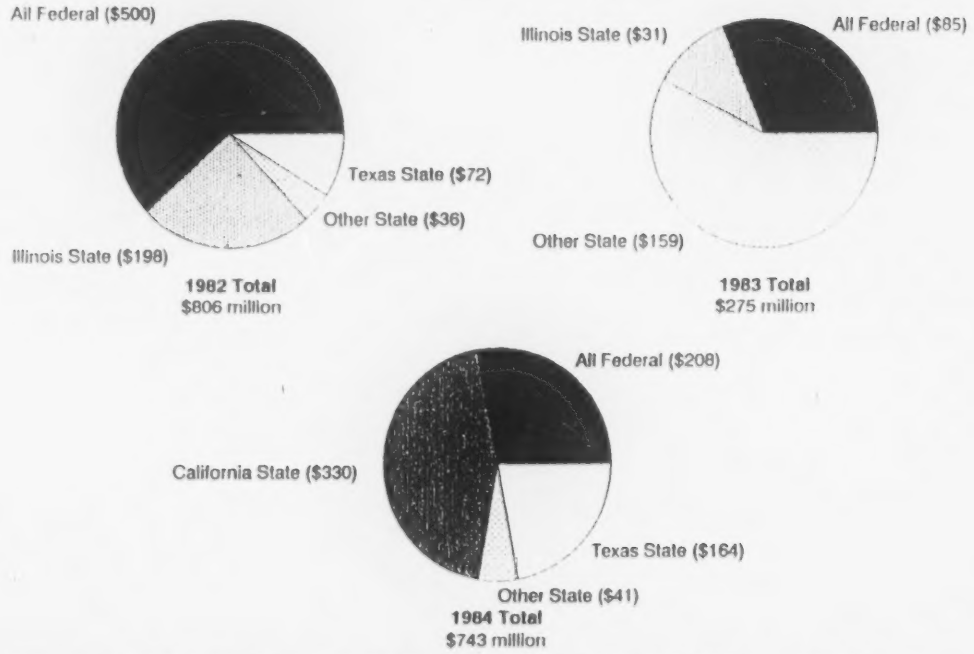

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Office of the Chief Economist/sjp

FSLIC and RTC Resolution Costs for State-Chartered Institutions in Selected States*

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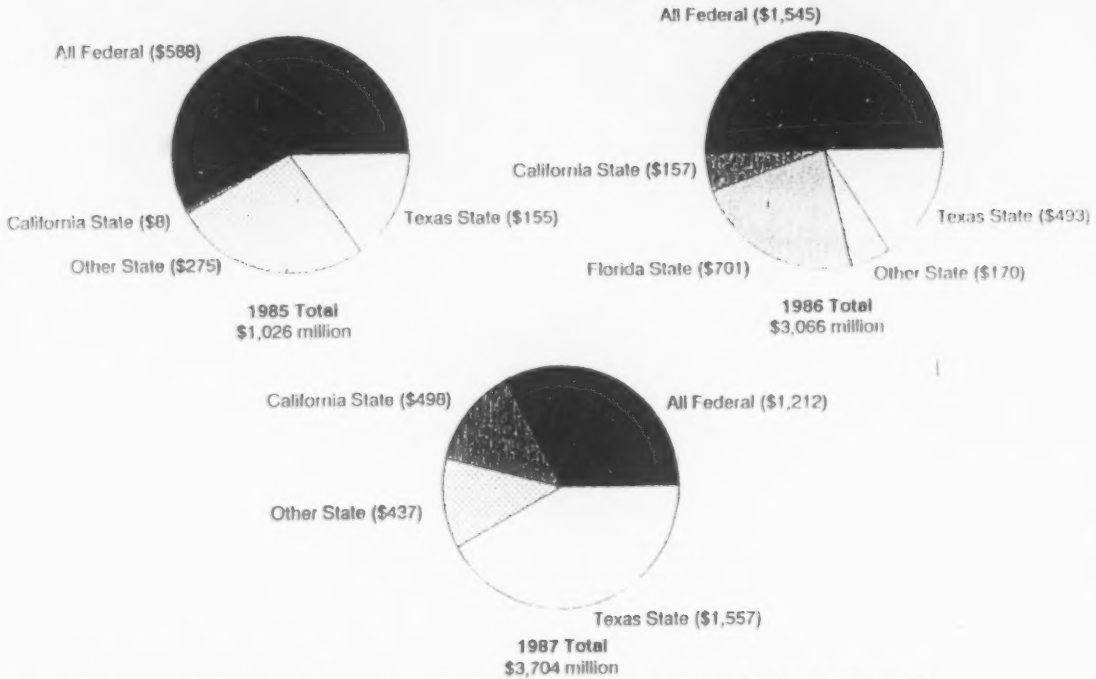


*Selected states include Texas, California, Florida, and Illinois. If one of the selected states is not shown for a particular year, there were no costly resolutions that year among that state's state-chartered institutions.

OTS/Office of the Chief Economist/sjp
September 10, 1990

FSLIC AND RTC RESOLUTION COSTS
FOR STATE-CHARTERED INSTITUTIONS IN SELECTED STATES

COST	1990	1989	1988	1987	1986	1985	1984	1983	1982	1982-90	1985-90	1987-90
TEXAS	2832	2787	17262	1557	493	155	164		72	25322	25086	24438
CALIFORNIA		597	5134	498	157	8	330			6724	6394	6229
FLORIDA		575	1154		701					2430	2430	1729
ILLINOIS		125	272					31	198	626	397	397
OTHER STATE	141	982	1021	437	170	275	41	159	36	3262	3026	2581
FEDERAL	2037	571	6944	1212	1545	588	208	85	500	13690	12897	10764
TOTAL	5010	5637	31787	3704	3066	1026	743	275	806	52054	50230	46138
TOTAL STATE	2973	5066	24843	2492	1521	438	535	190	306	38364	37333	35374

PERCENTAGE	1990	1989	1988	1987	1986	1985	1984	1983	1982	1982-90	1985-90	1987-90
TEXAS	56.53%	49.44%	54.31%	42.04%	16.08%	15.11%	22.07%	0.00%	8.93%	48.65%	49.94%	52.97%
CALIFORNIA	0.00%	10.59%	16.15%	13.44%	5.12%	0.78%	44.41%	0.00%	0.00%	12.92%	12.73%	13.50%
FLORIDA	0.00%	10.20%	3.63%	0.00%	22.86%	0.00%	0.00%	0.00%	0.00%	4.67%	4.84%	3.75%
ILLINOIS	0.00%	2.22%	0.86%	0.00%	0.00%	0.00%	0.00%	11.27%	24.57%	1.20%	0.79%	0.86%
OTHER STATE	2.81%	17.42%	3.21%	11.80%	5.54%	26.80%	5.52%	57.82%	4.47%	6.27%	6.02%	5.59%
FEDERAL	40.66%	10.13%	21.85%	32.72%	50.39%	57.31%	27.99%	30.91%	62.03%	26.30%	25.68%	23.33%
TOTAL	1	1	1	1	1	1	1	1	1	1	1	1
TOTAL STATE	59.34%	89.87%	78.15%	67.28%	49.61%	42.69%	72.01%	69.09%	37.97%	73.70%	74.32%	76.67%

The CHAIRMAN. Well, I want to compliment you on your testimony today and to say that I think it's been very forthcoming. I think it's been very pointed. You've addressed our questions that we have asked you to respond to very directly, and I think with great insight.

I appreciate the difficulty of the job that you have, you and your top staff people. It's just an enormous task. But I think what you've said to us today and the work you've been doing I think has really been a great credit to you and to your determination to deal with this situation. I think you've helped the committee a great deal today in terms of the work that's going on. I know there's a great deal left to do, so I don't mean to suggest by that that there isn't a tremendous amount of work that's ahead.

There clearly is.

I know Senator Graham just stepped out for a minute. He wants to come back and pose a couple of other questions to you.

In any case, I think we're making some progress here. It's very difficult and we've got a lot of the problem left to work through and the categorical areas that you've described today.

I appreciate the quality of the working relationship that we've been able to develop in terms of pressing ahead here. There will be times when we will need information or we're trying to understand precisely what's going on, where it may be difficult to get it or the staff may be busy doing a hundred other things and the last thing they may want to do is to stop and try to provide information that we're asking for.

But we appreciate their efforts and yours to get us the information we need because we want to do a good oversight job. We want to make sure that if the laws need to be adjusted in this area, that we act on a timely basis to adjust them. If there are lessons that need to be carried over into the banking system, we want to be able to start to apply some of those lessons there as well, perhaps with some modifications and what have you.

So, the information that we ask for, we only do it because we feel we need it and we want to do something constructive with it.

I take your answer a minute ago with respect to the future of the thrift industry to be, you said when you were here for your confirmation hearing that you were unsure at that time what you thought the future of the industry might be. And I gather your view is that—I'd like you, I guess, to try to take your last statement and sort of give me a bottom line to that, if you can.

Not that you can see the future, but your sense for whether or not you see a free-standing, separate thrift industry out there 2 or 3 or 4 years from now, or not.

Mr. RYAN. I'm going to put my lawyer/businessman hat on and say that, to me, at least for some of these institutions, it looks like a very good niche business. If you manage your risks the right way, which you discussed before, and there are more available tools to do that now through securitization or ARM's, it's a business that may not get you in the top 100 of the Fortune 500, but it's a good, solid business.

Now, whether it's called the thrift industry or the banking industry, whether it's a niche of consumer banking, is something that I just think that we're going to have to wait and see what happens.

I do feel, however, that what we're doing now is long-term, very positive for the country from a consolidation standpoint. And I also hope that we're allowed to make it through this very critical time period and get the job done the right way and not really try to confuse too many people as to their different assignments.

That's why I have my comment in there about restructuring right now. It's too—we've assembled a really good group of people in each one of these agencies. They all have a specific idea of what they're supposed to do.

I really feel that the RTC is about to mature, and if we can provide some type of financing for the nonreal estate assets, we may be able to start moving some of those assets. It's just a matter of working it through in kind of a typical American fashion.

It's not like you would design it this way if you were in some more orderly place. But we're doing it. The job's getting done. And I think that the long-term results will be positive.

Once we're through that, or if you want to do it now and phase it in, my own specific view is, and a personal view, is that we really need some restructuring. This is just too complex. It needs some simplicity.

We'll go to meetings and half the time we're not even sure which hat we're wearing or who's supposed to make the decisions and who has input and is this a State? Is this Federal? Which Federal agency?

It's a pretty complicated situation, in my view, and too complicated. But for today's clean up, it's in place. It's starting to work, in my view.

I wouldn't radically change it in the middle of this storm. That's my bottom line message.

The CHAIRMAN. I appreciate what you've said.

Senator Graham?

Senator GRAHAM. Thank you, Mr. Chairman.

I'd like to ask questions in two areas. One is very short-term, and then the second is more mid-term.

Looking at what the Congress ought to do between now and the time we adjourn for this session, there have been a number of items suggested. One of those is that we should lift the current restrictions on premiums that can be charged by the Federal Deposit Insurance Corporation. And within that is whether that should only apply to the Bank Insurance Fund or should also apply to limits on the thrift portion of the fund.

What is your feeling on that subject?

Mr. RYAN. My view is that the bill now working its way through which uncaps the bank insurance premiums is appropriate.

The SAIF insurance funds, it's much more difficult to get a hold on what's an appropriate premium there, given the fact that we're involved in this clean-up or work-out.

So I can't give you what the specific amount should be for thrift premiums, Senator Graham. My sense, though, is that from the folks who have been really concentrating on that issue, that the premium structure that you placed in FIRREA is probably appropriate today.

Senator GRAHAM. So you would not recommend lifting the current legal limits on the thrift insurance fund.

Mr. RYAN. No. In fact, we met this morning at an FDIC meeting to deal with the issue of the bank insurance premiums. We discussed this a little bit, not in any depth. But I think the bill that's going through now that deals with giving us some flexibility at the FDIC on the BIF is appropriate.

Senator GRAHAM. The second question in the short-term agenda was the adequacy of supervision.

We had a long discussion on this discussion with Mr. Glauber of the Treasury a couple of days ago. Frankly, it was not very satisfying to me in the sense that he essentially avoided answering the question whether he thought that the capacity and quality of supervision met the standards which the Treasury would like to see accomplished.

He punted that question back to the individual regulatory agency. So from your perspective in OTS and FDIC, are you satisfied with the quantity and quality of supervisory capacity that you currently have?

Mr. RYAN. The answer is yes, but let me expand on it.

The OTS, as you know, because you were working on this bill when I was a pension lawyer, is a combination of really 13 or 14 different entities. So one of the reasons we consolidated the districts into the five regions and we have established a structure in Washington which can supervise those regions and the field offices or districts below them, is to get some consistency.

I would like to see more consistency and I'm hopeful that we'll have it soon.

As to the number of employees that we have, we need to increase the number of examiners. Interestingly enough, that means that we also probably can decrease the total number of employees we have in the organization. We just have too many people in back-office operations or in support functions that, in my view, would be better deployed to the field doing the job which is really what we're paid to do, which is to supervise these institutions.

So that, for instance, I gave the statistics—I don't know if you heard them—of we have about one examiner per 2.2 institutions. OCC has about one examiner for every two institutions.

Yet, we have about the same number of employees they have, which means that they have allocated a lot more of their personnel to the field because they supervise double the number of institutions that we have.

So we need to do a better job getting people out into the field. We're in the process of also doing that.

As far as the quality of the people, the quality of the people are really excellent. And I had nothing to do with this, but my predecessors went out and enticed some of the better bank regulatory people from the other agencies to join the bank board, now OTS, so that our senior people running the regions, we have three people who used to be head of bank supervision either for the OCC or the FED.

So we have some of the best people in the industry and they're training people the right way and they understand that they're in a very transitional environment. So it's hard to motivate people and to keep them all on board. But, also, on the other hand, the excitement of being involved in something that's controversial and

needing dedicated work, is, I think, keeping some of the better people around.

I can't comment on the other bank regulatory agencies in-depth, except to say that I have been impressed with the FDIC supervisory people. They seem to be good, solid underwriters.

They obviously, with their insurance hat on, have a little different view. And when I have on my insurance hat, I have a little different view as to how the world should work than a primary regulator. I'd much rather see people drive at 45 miles per hour rather than at 60. And that's an appropriate way for FDIC to work, especially given the environment in which we're living.

This is not a normal situation. We're dealing with a financial situation that is very unusual.

So I feel, when I sit down as an FDIC member, even though I have these multiple hats on and conflicts, I find myself going more and more with the conservative insurance view because that's just the safer way of doing it right now.

Senator GRAHAM. If I can continue with that issue of supervisory capacity in a couple of areas. One, the chairman alluded to the fact that there was an unnamed commercial bank which 90 days ago was considered to be strong and today is in conservatorship.

To me, that is an F grade in supervision if a bank can move from strength to failure in such a short period of time.

One of the things that supervision should give you the capacity to do is to anticipate so that you can shape events rather than just respond to them.

So on the issue of the degree to which the supervisory capacity within the agencies for which you have responsibility, can you comment as to their capacity to give you an adequate read of the future so that you can make pro-active management decisions?

Mr. RYAN. So much of it is judgmental, and in order to make those judgments, you have to have the tools available to you.

In one of my other appearances before this committee, I talked about the accounting system in place and the problems that I have with the historical cost accounting system and my attraction toward a market value system, which obviously gives us a better idea of what's happening at the time and puts us in a position where we can implement an early intervention program.

Senator GRAHAM. Are you satisfied with your capacity to do that now?

Mr. RYAN. Not totally. I'd like it probably to be better, but I also understand Senator D'Amato's comments. I think, clearly, identify the balancing act that's necessary here.

As you get into any of these issues, they just become more and more difficult.

Senator GRAHAM. Is there anything that the Congress could do to increase your level of satisfaction?

Mr. RYAN. Not today, Senator Graham, no.

Senator GRAHAM. I now to go a second issue, still under supervision, in terms of a standard, is consistency of supervision.

You mentioned that that was one of the goals of the central OTS office in relationship to its five regions. Could you comment as to the degree of consistency of regulatory actions that existed in the

pre-OTS period, what your historical assessment of that is, and then what is the degree of consistency under the current pattern?

Mr. RYAN. My comments will be purely anecdotal because I was not around at the time they had 12 districts and a bank board, as opposed to a specific agency that's part of Treasury which is also in some sense related to a sister agency, OCC, that's been around a long time.

Anecdotally, it appears that many of the districts were run on a very separate basis. So that there probably was not an awful lot of consistency between the work done in one district and another.

That's kind of just a general anecdotal comment.

We'd like to do a better job at that now. So it's one of the reasons we essentially consolidated the districts into the regions.

The other thing that is, I'm sure, a nuisance at times for some of the people in the field, I view as a benefit, and that is that we do have in some of these institutions multiple supervisors.

So that, for instance, when we go into an institution, frequently, we're accompanied by FDIC personnel. In many of the States, we also have state supervisors who are in these institutions. Today, given the climate in which we're working, and the atmosphere and the risks, as long as we are all using the same script, I think that that probably is helpful.

On the other side, are examiners and supervisors too tough, over-reacting to the environment in which we're living?

Chairman Greenspan,I think, best stated it—they're human beings, so they react to pressure in a very similar fashion. So I'm sure out in the field, people are a little bit tighter than they have been. And at least in our industry, that, from my standpoint, on balance, is good.

We have a problem we're working with now.

Senator GRAHAM. Mr. Chairman, I have some more questions, but I'm way past my 5 minutes.

The CHAIRMAN. I just want to ask one more and then I'm going to let you continue.

And that is, as you look at the real estate problem across the country, not that that's where your principal focus is, but you're feeling it as you're looking at these thrift situations and problems in the thrifts in all categories, but especially groups III and IV.

Chairman Seidman has indicated to us that he has this map that's coded by color of the 50 States and it shows the degree to which the real estate problem and erosion of value seems to be spreading across the country. It sort of moves from region to region and includes more regions.

The general sense that I have at the moment is that this downward valuation in real estate is still continuing and that it's quite pervasive and that it's hollowing out posted balance sheet values of a lot of outstanding loans and assets, and that it's just one of those tides that's running through this problem right now in a soft economy and with other problems that are out there.

But is it your sense that there is a continuing erosion of real estate values that is part of the fabric of this problem at the present time?

Mr. RYAN. You introduced the question appropriately. I'm not a real estate expert, so I'll only tell you what the economists at OTS tell me.

And that is that the problem appears to be shifting, not only to the northeast, but down the Atlantic seaboard. It's isolated at least the really significant problems to those lenders who have made significant commercial loans.

There is some weakness on the residential side, but it's not like the commercial arena.

We have our own map which we'll be glad to give it to the committee, and we're going to start putting out this information in the next quarter. But it sets out the percentage of thrift industry as opposed to banking. The FDIC does banking—thrift industry noncurrent real estate loans. And it breaks out into 2 percent or less, between 2 or 3 percent, and 3 percent or higher.

It's predictable where you would see it. It's the southwest States, New York, Massachusetts——

The CHAIRMAN. The 3 percent or higher category?

Mr. RYAN. Yes, sir, 3 percent or higher are in Texas, New Mexico, Louisiana, Arkansas, Mississippi, Alabama. You go up then into the northeast and you find it very high. The highest is Rhode Island, almost 9 percent. Seven percent in Massachusetts. Four and one-half percent in New York. Four percent in New Jersey. Four percent in Virginia.

We'd be glad to supply this to you.

The CHAIRMAN. Yes. I'd just as soon—I guess my question, too, is, are the number of States in the category of 3 percent and above generally increasing? And I would get the impression that——

Mr. RYAN. Well, it's spread to the northeast and down the Atlantic coast. The bottom half of the country there, the southwest would look the same, at least the maps I've seen over the last couple of quarters, that hasn't changed. They're still shaded. In fact, their percentage may be going down.

There appears to be improvement in many of the Texas markets—Houston, Dallas.

The CHAIRMAN. Of course you've got the overhang. I think almost 70 percent of the total asset value of the assets in the RTC are within the State of Texas. So the real estate overhang problem is the greatest in Texas because that's where most of those assets are right now in the RTC.

I noticed that California——

Mr. RYAN. Mr. Chairman?

The CHAIRMAN. Yes.

Mr. RYAN. The real estate is only 13 percent of our portfolio at the RTC. So that's 70 percent of 13 percent. So much of, as you know as well as I do, so much of the assets are mortgages and securitizable, we think, highly marketable financial assets.

And they're not limited to any specific area of the country.

The CHAIRMAN. As I look at this map and I look at California, for example, and of course California is such a big part of the country, economically, it's at 1.32, this is through June 1990.

Mr. RYAN. That's based on second-quarter data.

The CHAIRMAN. Yes. So I suppose what you're watching for here is to see if you're going to start to see a pick-up in these numbers

which would mean a deterioration in States like California or it would be another major region.

Is that sort of what you——

Mr. RYAN. We pull that information off of the thrift financial reports and we make it available to our senior managers around the country and we use it as a tool to do a more effective job in allocating resources.

One of the reasons, quite frankly, we've made this decision, as I announced today, to basically go into half of the institutions pretty immediately is to get a better fix on exactly where the problems are and to try to get a sense of what's happening in the future before it happens, because anticipation is important here.

The CHAIRMAN. Well, that's what we're trying to do as well. We're trying to get a sense for what the economic dynamics are that are working the country, especially in this real estate area, because of the balance sheet implications for thrifts and banks in these different categories.

We've got one set of problems in the thrift area. I'm very much concerned about what we have going on in the banking area, as you know, because we've drawn our—as you were meeting earlier today and the decision as to whether or not to raise the bank insurance premiums, we're down to a paper-thin margin in the Bank Insurance Fund.

So the whole question of an erosion of value as it would affect regions or individual institutions is something that we're making an effort to track very closely.

As you know, we've had the GAO and the CBO in to say that if a single big bank were to go down—we hope that that won't happen—that that could take the rest of the balance in the insurance fund by itself.

And so we're obviously at work to try to figure out how we take and strengthen that situation and give ourselves more of a margin, not just with insurance premiums, but with that more substantial legislative package that we put out that you referred to earlier.

I would appreciate it if you see any other important economic trend line information, whether it's real estate prices or other things that bear on this, if you see it, that you bring it to our attention so that we have a chance to try to incorporate that into our thinking.

Mr. RYAN. I'd be glad to.

The CHAIRMAN. I'm going to now have Senator Graham finish up the hearing. I must go to something else. But I again appreciate your testimony today.

Mr. RYAN. Thank you.

The CHAIRMAN. Senator Graham?

Senator GRAHAM [presiding]. Thank you very much, Mr. Chairman.

I would just like to go to the last area, which is the final section of your presentation, and that is the future of the industry.

You talk about the fact that there are institutions, particularly in groups I and II, that you think will be able to be profitable and find a niche.

What do you see as the public policy justification for continuing to have a separate thrift industry over the next 10 years?

Mr. RYAN. Are we talking now from a regulatory standpoint or from a business standpoint?

Senator GRAHAM. From the standpoint of what are the needs of society to be served that warrant of a separate thrift industry?

Mr. RYAN. First of all, the regulatory and statutory differences between thrifts and other financial institutions are really merging, and they'll continue to merge as we phase out of certain thrift-unique type affiliated activities.

As I said before, from a regulatory standpoint, I think we need to see what is going to happen with the industry. We need to let the economics of the situation dictate whether there remains a large enough core business, segregated business, that needs separate regulation.

I think the business issue is a much easier issue for me, Senator Graham.

My sense is that this is a niche business within financial services that is attractive. It's attractive because the risks are lower than some of the other businesses available to financial service providers.

What I have found most interesting in this 6 months I've been in the job, because whenever I visit one of our offices, I meet not only with thrift executives, but with bank executives.

Many, many of the bank executives tell me the same thing, and that is that they find this business very attractive. They're very interested in acquiring thrifts as access to the mortgage markets and to kind of more consumer-oriented services. It's more predictable.

It's interesting. It shows you some of the other businesses they've been pushed into.

So I'm sure from a business standpoint, there's a niche. Now, from a public policy standpoint, do we need to have a separate apparatus to deal with thrifts? I think that that's going to be—the answer for me is going to be evolving. I mean, the only thing that I know today is that the regulatory structure that exists is too complex, in my view. I think that simplicity is necessary.

I also, however, feel that we're involved in the biggest clean-up and work-out we've ever had in this country. And we don't need to rearrange all the deck chairs right now. I mean, I wouldn't want to see that happen right now. If there's some decision that's made next year to—whatever it may be, impacting the thrift industry, impacting any industry, credit unions, whatever, from a regulatory standpoint, the only suggestion I would have is phase it in and make sure that the date is sometime outside of the date that we finish, we feel that we can really finish this work-out, because if we did it today and we combined all these agencies, we'd lose another year or two just because of the internal bureaucratic confusion.

And we're finally now getting our act together. That's my view.

Senator GRAHAM. A question which I think has got to have some serious attention is, is there in our economic society today a rationale for a separate thrift industry?

That's a question that has and is being asked of many other national economic structures.

I was in Spain earlier this month. Spain in the late 1970's and early 1980's had a crisis of its thrift industry. Its response to that crisis was to terminate the thrift industry and go to what they call

a universal bank. And at least the people I talked to felt that the 10 years that have intervened since that decision had indicated it was a wise decision. And their costs of resolving the crisis that they had was reduced by having made it.

In 1989, when faced with a crisis in the thrift industry, we essentially said, we're going to keep a separate thrift industry and reform it.

I think we need to continue to ask the question, what are the external economic justifications for a separate thrift industry? Do they warrant maintaining our 50-year tradition of a separate thrift industry? And if they don't, what is the most graceful way to get from where we are to what would be a more appropriate way?

And I think, as you've underscored several times, part of that grace is to recognize that we're doing this in a very stormy situation and our options aren't just strictly theoretical. They have to have a high degree of pragmatism. How do they affect our ability to get out of this storm?

I don't know if that was a question or an editorial.

Mr. RYAN. No, but you accurately stated my position.

Senator GRAHAM. But I would hope that we could continue over the months ahead to occasionally stop to ask the very important question which you brought so effectively to our attention today, and that is, where are we trying to go? What is in the best interest of the nation? What are the economic needs? And do they continue to warrant having a separate thrift industry.

Mr. RYAN. And I think we're evolving into an answer to that question and for me, the only hesitation I have in this kind of evolutionary answer is that there may come a time where it's just too costly to evolve and we may have to make a decision one way or the other.

Quite frankly, I'm just not in a position yet because I've only been in the job 6 months. If you said to me, well, what's your answer today, I really couldn't give it to you because I don't know enough yet and I'm in the process of trying to learn more so that I could answer that question.

I know that through FIRREA, many of the differences between thrifts and banks are going to disappear.

Senator GRAHAM. Mr. Ryan, thank you very much for your very helpful and very thoughtful comments and testimony today.

Mr. RYAN. Thank you.

Senator GRAHAM. The hearing is adjourned. Thank you.

[Whereupon, at 12:55 p.m., the hearing was adjourned.]

[Response to written questions follows:]

RESPONSE TO WRITTEN QUESTIONS OF SENATOR KERRY FROM

ANTHONY M. FRANK

Q.1. Mr. Frank, in your testimony, you state, "If I were redoing the law, I would question permitting state chartered institutions. This dual licensing system where one licensor has no financial responsibility for insuring the firms they make the rules for, hasn't worked well in the past. Most of the problem thrifts, I believe, were state chartered, rather than federal."

I agree with you absolutely on this point. 70% of the thrift failures in this country occurred in Texas and three quarters of those institutions were state chartered. I have argued before that we need some kind of regional approach to this bailout -- we in the northeast and the midwest are paying for the nonfeasance of state thrift regulators and often times malfeasance of thrift executives in Texas and the southwest.

I'm sure you've seen the numbers. Each taxpayer in Massachusetts is paying out $1,026 in taxes for the bailout and in Texas, where 70% of the failures occurred, the benefit per person is calculated to be $4,775.

Why shouldn't the southwest be bearing a larger share of the burden in this crisis?

What exactly would you do to replace the dual licensing system? Would you eliminate the state regulators or would you have states share the burden for deposit insurance?

A.1. There is no doubt the citizens of other regions are paying for the fraud and malfeasance involving Texas savings and loans, yet I believe (without the benefit of statistics) the basic reason for the high cost was the collapse of the Oil Patch. Even the most prudent lender, when values drop more than 20%, will have his or her loans "underwater." I am no macroeconomist, but a case could be made that the collapse of oil prices in Texas, Louisiana, and Oklahoma benefitted other regions, while punishing the institutions that lent on real estate in the three-state region.

Deposit insurance on a state by state basis is clearly unworkable because the universe covered is too uniform and too small for "the safety of large numbers." Having the states share the burden for federal insurance would most probably mean extra fees from state-chartered institutions, weakening them. Making the rules while having no financial responsibility for the effect of those rules is clearly unworkable.

Q.2. Mr. Frank, in your testimony you state that "The only way for the RTC to minimize criticism is to sell all real estate properties immediately, in bulk, or through brokers, or at auction. The enormous losses generated by such a policy can be reduced by investing in and holding property rather than dumping (particularly in an over-saturated market); however, this approach involves risk, possible censure and courageous uncommon judgment."

I have two questions for you. First, I have read that the costs of keeping real estate assets on the RTC's books are so steep -- often three percent of the appraised value per month -- these costs include maintenance, real estate taxes, utilities and insurance. How would your proposal to dissolve the RTC and to shift responsibilities for the administration of the cleanup over to a blue-ribbon board comprised of private sector individuals in any way diminish those carrying costs? If the costs cannot be reduced, why do you argue that it makes sense to hold onto the property?

Secondly, what makes you think that a private sector board, that is subject to Congressional authorization and Congressional oversight and that reports to the Treasury or the President, will have any more independence than the current RTC and will be willing to exercise the "courageous uncommon judgment" that you have referred to?

A.2. Certain forms of real estate, primarily houses, should be sold as quickly as possible. They do cost up to three percent per month (unless they are rented) and the future appreciation of such properties is hardly likely to make up for the costs of holding. This generalization may not be correct for income producing properties and land. A sophisticated buyer of an apartment house, a shopping center, or an office building will calculate the length of time required to get tenants whose rent will equal or exceed the cost of holding the property. Based on this calculation, the sophisticated buyer will "low ball" an offer to the RTC.

Even partial income from a building can be enough to help offset the holding costs. Experience in other markets has shown that when new construction is curtailed, as now, existing apartments, shopping centers, and office buildings often have both their rent per square foot and their occupancy percentage improve dramatically over a relatively short period of time (three to five years). Private sector judgment can determine in which cases it makes sense to hold the incoming producing property and when it makes sense to immediately sell such property.

The holding costs for raw land, of course, are much less than the three percent per month that you indicate. Here judicious pursuit of proper zoning, coupled sometimes with financing for the intended improvement, can materially increase the value of the raw land temporarily being held off the market.

I am not positive a private sector board can do any better job than the current RTC, but the plain fact is that the RTC system is not now working. We need to try something else. This "something else" will have to exercise extraordinary judgment which will inevitably involve mistakes. Having a private sector board will, in some measure, insulate the RTC employees from press and Congressional criticism for these mistakes. No one is critical of an oil wildcatter who only hits a gusher one or two times out of ten. No one is critical of a private sector builder who has two failures, four breakeven projects, and four winners out of ten.

Q.3. Mr. Frank, Bert Ely, an economist who has spent a great deal of time studying this issue, also believes that we need to restructure the cleanup process. However, his propsoal is somewhat different than yours. Instead of appointing a blue-ribbon private sector commission to administer the bailout, Mr. Ely would combine the RTC, the FSLIC Resolution Fund, and the Oversight Board. Ely proposes that this restructured RTC and all of its employees then be placed directly under the Treasury Department. According to Ely, this would completely sever the RTC from the FDIC so that the FDIC could return to its traditional role of operating solely with unappropriated funds. The RTC would be spending only appropriated funds and would be treated like any other agency within a cabinet department.

What is your reaction to Mr. Ely's proposal and why does your reorganization plan make more sense?

A.3. I would adopt part of Bert Ely's recommendation to combine the RTC, the FSLIC Resolution Fund, and the Oversight Board, and separate it from the FDIC. But I would buffer it from the bias and red tape that seem to come with Treasury Department direct reporting.

As I stated at the hearing "We are in a national emergency and we are not acting like it." More time is being spent at the RTC, under Treasury Department direction, to appear fair than to sell the properties. Are you aware that darts are being used to determine the random selection of real estate administrators? A private sector bank or savings and loan association that has a

problem piece of real estate and needs an outside administrator, merely selects that administrator, rightly or wrongly. The administrator then proceeds to deal with the property. Contrast that with our present situation of prequalification, random selection, bidding, contracting, and supervision. I am in hopes that a private sector board could do away with the excessive demonstration of "fairness" that the bureacratic approach affords, and that this private sector board would be able to save tens of billions of dollars for American taxpayers by buffering RTC workers from criticism.

Q.4. Mr. Frank, you have called the savings and loan crisis a "true national emergency" that has the potential to make our nation a "second rate power." I completely agree with you.

How did this national emergency arise? Why do we find ourselves confronting this terrible problem?

A.4. As I indicated in my testimony, I believe that it is time to look ahead, but I understand the American people and their representatives, at the very least, need an analysis of what happened so it will not happen again.

The fact is that there is plenty of blame to go around. State chartering entities, such as the California Savings and Loan Commissioner and the Texas Commissioner began to build "a better mousetrap" to keep their constituents from defecting to the federal system. Federal regulators badly confused the idea of deregulation with less supervision--of course deregulation should mean more supervision as financial institutions use the increased powers granted them from the Garn-St. Germain bill. Those federal examiners were badly underpaid and the turnover was horrendous. No capital requirements were imposed on existing institutions, and, indeed, they were encouraged to "grow out of their problems." The federal government began to be a potent competitor, through Ginnie Mae, Fannie Mae, and Freddie Mac, for good portfolio loans. This drove financial institutions into riskier niches. New entrants into the industry were not, apparently, closely inspected as to their probity and background. The industry, through its trade associations, refused to press for more bailout funds and for tougher lending standards. The regional banks, which had the most qualified and the most highly paid employees, were ignored and even reviled by federal regulators. Commercial banks saw (and see) the dilemma of the savings and loan business as a chance to get rid of an old and despised competitor. Finally, regional economic diasters, such as the collapse of the Oil Patch, severly impacted the financial status of the FSLIC.

Ed

Office of Thrift Supervision
Department of the Treasury

Timothy Ryan
Director

1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6260

December 5, 1990

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

Thank-you for the opportunity to testify before your Committee on September 27, 1990, regarding the condition of the thrift industry.

During the hearing, you asked us to provide answers to the following questions:

1. What percentage of home mortgage originations now are variable rate versus fixed rate mortgages?

2. I'd like to know how you see what constitutes some kind of a "supervisory management program" and what is the approximate asset value of the institutions which may qualify for this program?

3. If you broke the decades of the 1970s and 1980s into five year segments, what would be the breakdown of failures in state chartered versus federally chartered institutions? And what was the percentage of total state versus thrift charters during those periods?

We have enclosed answers to the above questions and trust you will find them responsive to the needs of the Committee.

Sincerely,

Timothy Ryan

Enclosures

Question #1. What percentage of home mortgage originations now are variable rate versus fixed rate mortgages?

Answer #1. See attached

PERCENT OF FIXED AND VARIABLE RATE LOANS BY LENDER TYPE (1990)

	All Lenders		Savings & Loan Associations		Commercial Banks		Mutual Savings Banks		Mortgage Companies	
	Fixed	Variable	Fixed	Variable	Fixed	Variable	Fixed	Variable	Fixed	Variable
January	80.7%	19.3%	69.5%	30.5%	82.4%	17.6%	61.0%	39.0%	92.7%	7.3%
February	75.0%	25.0%	63.1%	36.9%	74.8%	25.2%	66.8%	33.2%	88.3%	11.7%
March	73.2%	26.8%	61.0%	39.0%	78.4%	21.6%	67.2%	32.8%	83.0%	17.0%
April	72.9%	27.1%	56.8%	43.2%	81.0%	19.0%	59.0%	41.0%	85.3%	14.7%
May	70.4%	29.6%	56.7%	43.3%	72.1%	27.9%	61.2%	38.8%	83.2%	16.8%
June	67.6%	32.4%	53.0%	47.0%	74.6%	25.4%	53.5%	46.5%	79.8%	20.2%
July	70.3%	29.7%	52.9%	47.1%	78.9%	21.1%	55.3%	44.7%	84.3%	15.7%
August	72.4%	27.6%	56.3%	43.7%	75.1%	24.9%	60.1%	39.9%	87.7%	12.3%
September	72.5%	27.5%	59.7%	40.3%	78.2%	21.8%	54.1%	45.9%	89.3%	10.7%

Office of Thrift Supervision/Surveillance & Analysis 10/19/90

Question #2.. I'd like to know how you see what constitutes some kind of a "supervisory management program?"

Answer #2. The objective of the supervisory management program (SMP), which is still being developed by OTS and FDIC, is to maintain or improve the franchise value of qualified Regulatory Management System (RMS) Group IV institutions for the purpose of minimizing the cost to the taxpayer prior to a permanent resolution. The SMP would be a pre-resolution approach to the operations of Group IV institutions that are stable and meet specific qualification criteria.

Candidates for SMP include institutions in RMS Group IV designated for resolution within six to twelve months through the Accelerated Resolution Program (ARP). These institutions should have capable and acceptable management, a low risk profile and be at or near profitability. The OTS regional office, with concurrence of the FDIC, will identify appropriate candidates.

There are currently 83 candidates for this program with total assets of approximately $68 billion. However, it should be noted that the number and asset value of this group is in a constant state of change.

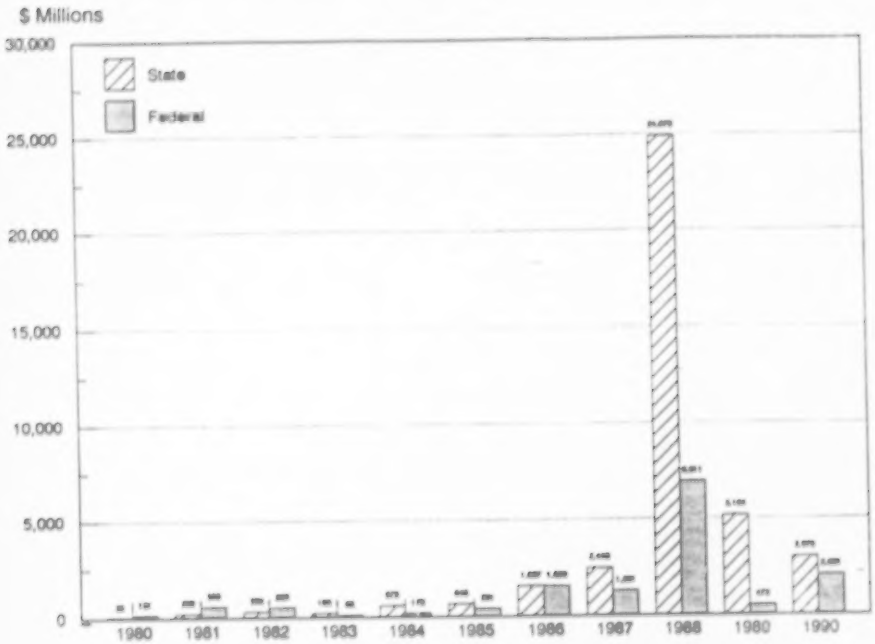
Question #3. If you broke the decades of the 1970s and 1980s into five year segments, what would be the breakdown of failures in state charters versus federally chartered institutions? And what was the percentage of total state versus thrift charters during those periods?

	RESOLUTIONS		AVERAGE NUMBER OF INSTITUTIONS		
	State Charter	Federal Charter	Savings Banks	State Charter	Federal Charter
1971-75	9	5		2118	2050
1976-80	10	16		2039	2001
1981-85	69	111	137	1589	1613
1986-90	200	174	579	1137	1225

Chart 1

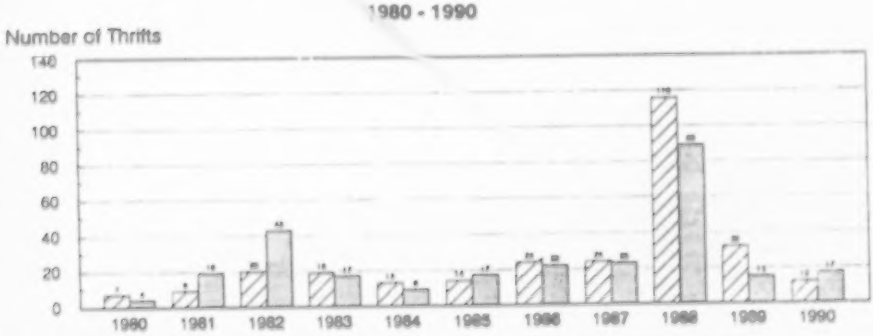
Resolution Costs of State and Federally Chartered Thrifts

1980 - 1990



State and Federally Chartered Thrift Resolutions

1980 - 1990



OTS/Office of the Chief Economist

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OBS	YEAR	ST_FED	_TYPE_	_FREQ_	TASSET
1	.		0	565	194686285
2	.	ST	1	276	116353903
3	.	FED	1	289	78332382
4	1980		2	11	1348908
5	1981		2	28	11451905
6	1982		2	63	13137476
7	1983		2	36	4569540
8	1984		2	22	5115612
9	1985		2	31	6307051
10	1986		2	46	12178469
11	1987		2	47	10490864
12	1988		2	205	102369617
13	1989		2	47	13278681
14	1990		2	29	14438163
15	1980	ST	3	7	579926
16	1980	FED	3	4	768982
17	1981	ST	3	9	2491746
18	1981	FED	3	19	8960158
19	1982	ST	3	20	3842032
20	1982	FED	3	43	9295445
21	1983	ST	3	19	2471692
22	1983	FED	3	17	2097848
23	1984	ST	3	10	1508542
24	1984	FED	3	12	3607069
25	1985	ST	3	11	1764805
26	1985	FED	3	20	4542246
27	1986	ST	3	22	5434874
28	1986	FED	3	24	6743595
29	1987	ST	3	24	5229148
30	1987	FED	3	23	5261716
31	1988	ST	3	112	72800007
32	1988	FED	3	93	29569610
33	1989	ST	3	31	12273498
34	1989	FED	3	16	1005183
35	1990	ST	3	11	7957633
36	1990	FED	3	18	6480530

RESPONSE TO WRITTEN QUESTIONS OF SENATOR HEINZ FROM
T. TIMOTHY RYAN

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, D.C. 20552 • (202) 906-6288

December 12, 1990

The Honorable Donald W. Riegle, Jr.
Chairman, Committee on Banking,
Housing, and Urban Affairs
534 Dirksen Senate Office Building
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

This is in response to your October 16, 1990 letter presenting follow-up questions from the September 27, 1990 hearing on the condition of the thrift industry.

Again, I want to thank you for the opportunity to testify before your Committee, and I trust this is responsive to the Committee's questions and to yours.

Sincerely,

Timothy Ryan

Enclosures

Q.1. You state in your testimony (at page 26) that you support the administration's proposal to provide the FDIC with greater flexibility to raise deposit insurance premiums. Under current law and under the Treasury proposal, the FDIC sets deposit insurance premiums for the bank fund and the Savings Association Fund independently based on the conditions in each industry and the condition of funds.

However, you also recommended (at page 30) that the FDIC eliminate the disparity in insurance premiums paid by banks and thrifts to assure competitive equality?

Should the FDIC set premiums based on the condition of the insurance fund or on the basis of the effect on the competitiveness of the two industries?

Since under FIRREA, the thrift industry is supposed to be devoted to housing finance, in what way do you see the bank and thrift industries competing -- other than for deposits?

A.1. OTS still supports the view that the FDIC should have flexibility to set premiums and rebate levels for insured institutions. The rate should be based on the condition of the insurance funds with FDIC required to factor in the effect of any rate increase on the earnings and capitalization of insured institutions.

In this same light, thrift premiums should be determined based on the condition of the insurance fund with consideration given to the thrifts' ability to pay. If possible, the premiums should be level for banks and thrifts. Level premiums allow for competitive equality and avoid distorting the deposit market.

The thrift industry is, indeed, devoted to housing finance under FIRREA; it is in this area that banks and thrifts will compete in the future. Banks have continued to increase their mortgage originations and holdings. As the thrift industry shrinks, banks may continue to grow into the area of mortgage finance.

Q.2. In your testimony (at page 5) you point out that the OTS and the bank regulators have agreed to impose a higher minimum leverage ratio of at least 4 percent for all but the strongest institutions. As a result, 100 thrifts with assets of 108 billion dollars which meet the current capital standards will fail to comply with the minimum capital standards.

In addition, you stated (at page 10) that minimum capital standards will continue to increase because FIRREA phased-out the inclusion of certain assets, such as supervisory goodwill, in the computation of capital.

How many thrifts currently meet the fully phased-in capital requirements? In other words, how many more savings and loans can we expect will fail to meet minimum capital standards in the next few years?

A.2. As of June 30, 1990 data, approximately 1,300 of the 2,454 non-conservatorship savings associations meet the fully phased-in capital standards.

Going forward, it is not possible to know, or predict with any degree of accuracy, the number of institutions that will not pass the minimum requirements. The number that do not pass will depend in large part on behavioral and economic factors. For example, savings associations can be expected to restructure their portfolios to lower their risk-based capital requirements. Further, the FIRREA capital requirement imposed on investments in and loans to subsidiaries that engage in activities impermissible for national banks gives institutions the incentive to sell these subsidiaries (and thereby lower their minimum capital requirements).

A key determinant of institutions' financial health -- including whether they pass the minimum capital standards -- is the general state of the economy. As we do not know exactly what interest rates and other key economic factors will be in the coming years, we are reluctant to speculate on the number of institutions that might not pass the capital standards.

Q.3. As you mentioned in your testimony, a great number of thrifts are under pressure to attract capital to meet higher capital standards.

At our previous hearing on the condition of the thrift industry, each of the witnesses stressed the importance of enhancing the value of the thrift charter. Investors are not going to bring capital to the thrift industry if the industry cannot earn a competitive return.

In your view, was the value of the thrift charter reduced as a consequence of FIRREA? If so, how?

What can be done to enhance the value of the thrift charter without increasing the risk to the deposit insurance fund?

How would you compare the value of the thrift charter with the value of a bank charter?

A.3. FIRREA's Effect on Thrift Charter Value

The value of the thrift charter is almost certainly lower after FIRREA than it was before. The higher capital standards mandated by FIRREA mean a lower return on equity for thrift investors for a given return on assets. Additionally, the qualified thrift lender (QTL) test and other constraints on thrift asset powers imposed by FIRREA further reduce the attractiveness of investing in a thrift. Finally, FIRREA increased the cost of doing business for thrifts by raising insurance premiums and assessments.

One countervailing factor is the financing FIRREA provided to close troubled thrifts. Troubled institutions often pay high interest rates on deposits in order to attract funds and underprice loan products to generate short-term, marginal revenues. This has a highly adverse effect on healthier institutions. Thus, removing the non-viable thrifts from the market has a positive effect on the charter value of the viable segment of the industry.

Increase Charter Value

Increased efficiency in regulation will help to improve thrift charter value without increasing the risk to the deposit insurance fund. Efficiency gains in regulation translate into cost savings for the industry. The best way to use limited regulatory resources is to target those resources by focusing on special thrift industry problems, concentrate examination and supervision staff on riskier institutions, and apply differential regulation--tightening constraints on weaker institutions while leaving strong, well-capitalized, well-managed institutions to function with maximum flexibility.

Additionally, some easing of the QTL test may improve the thrift's charter value without necessarily increasing risk. In particular, we recommend broadening the definition of qualified thrift investments to include some liquid assets that thrifts must maintain for liquidity purposes.

Thrift vs. Bank Charter Value

FIRREA has blurred, and in many cases abolished, many traditional distinctions between banks and thrifts. For example, in the past, thrifts had lower capital requirements than commercial banks. Now, under FIRREA, the capital standards for thrifts can be no less stringent than those for national banks. Thus, the advantage that the thrift charter had to lever capital has been eliminated. At the same time, FIRREA strengthened the requirement that thrift institutions maintain a primary commitment to residential mortgage lending. The QTL test, applicable only to thrifts, may lessen the attactiveness of the thrift charter compared with the bank charter.

The exact economic value of a thrift charter in the post-FIRREA world is unclear. While it may have less value now than before FIRREA, a bank charter is not necessarily of greater relative value, especially for an institution specializing in residential mortgage activities.